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91-1194

Supreme Court, U.S.
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No. _____

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1991

MELLON BANK, N.A.,
and
GRANT STREET NATIONAL BANK (IN LIQUIDATION)
Respondents,

vs.

METRO COMMUNICATIONS,INC. t/a METROSPORTS
Respondents,

vs.

THE COMMITTEE OF UNSECURED CREDITORS
Petitioners.

Petition for Writ of Certiorari to the
United States Court of Appeals
for the Third Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether the location of a company's "chief executive office" under section 9103(c)(4) of the Uniform Commercial Code is a "question of law" or a "question of fact", subject to the restrictions of the "clearly erroneous" standard of review?

2. Whether the trial court's determination that the Debtor's "chief executive office" was in Pennsylvania was "clearly erroneous" when, *inter alia*, its chief executive officer, chief financial officer and other financial management were located in Pittsburgh?

PARTIES TO THE PROCEEDING

The parties to the proceedings in the court below were: Mellon Bank, N.A.; Grant Street National Bank, and the Committee of Unsecured Creditors of Metro Communications, Inc., on behalf of the Debtor's estate in bankruptcy.

Total Communications, Incorporated is the parent corporation of Metro Communications, Incorporated. The Committee of Unsecured Creditors of Metro Communications, Inc. consists of The Big East Conference, the University of California at Los Angeles, the Big Ten Conference, American Security Bank and the United States Naval Academy.

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Petition for Writ of Certiorari to the
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PETITION FOR A WRIT OF CERTIORARI

The Committee of Unsecured Creditors of Metro Communications, Inc. respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Third Circuit in this case.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Third Circuit is reported at 945 F.2d 635. App. 1. The memorandum opinion of the United States District Court for the Western District of Pennsylvania and its order affirming the judgment of the bankruptcy court is unreported. App. 47. The memorandum opinion of the United States Bankruptcy Court for the Western District of Pennsylvania is reported at 95 Bankr. 921, App. 53; its order is reported at 95 Bankr. 934. App. 89.

JURISDICTION

The court of appeals entered its judgment on September 25, 1991. App. 38. A petition for hearing was filed on October 9, 1991. The Court of Appeals denied the petition for rehearing on October 23, 1991. App. 98. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1)(1988).

STATUTES AND RULES INVOLVED

Federal Rule of Bankruptcy Procedure 8013

On an appeal the district court or bankruptcy appellate panel may affirm, modify, or reverse a bankruptcy judge's judgment, order, or decree or remand with instructions for further proceedings. Findings of fact, whether based on oral or documentary evidence, shall not be set aside unless clearly erroneous, and due

regard shall be given to the opportunity of the bankruptcy court to judge the credibility of the witnesses.

13 Pa.C.S.A. §9103(c), Uniform Commercial Code, Act 1979, Nov.1, P.L. 255, No.86

(c) Accounts, general intangibles and mobile goods -

(1) This subsection applies to accounts (other than an account described in subsection (e) relating to minerals) and general intangibles and to goods which are mobile and which are of a type normally used in more than one jurisdiction, such as motor vehicles, trailers, rolling stock, airplanes, shipping containers, road building and construction machinery and commercial harvesting machinery and the like, if the goods are equipment or are inventory leased or held for lease by the debtor to others and are not covered by a certificate of title described in subsection (b).

(2) The law (including the conflict of laws rule) of the jurisdiction in which the debtor is located governs the perfection and the effect of perfection or nonperfection of the security interest.

(3) If, however, the debtor is located in a jurisdiction which is not a part of the United States and which does not provide for perfection of the security interest by filing or recording in that jurisdiction, the law of the jurisdiction in the

United States in which the debtor has its major executive office in the United States governs the perfection and the effect of perfection or nonperfection of the security interest through filing. In the alternative, if the debtor is located in a jurisdiction which is not a part of the United States or Canada and the collateral is accounts or general intangibles for money due or to become due, the security interest may be perfected by notification to the account debtor. As used in this paragraph "United States" includes its territories and possessions and the Commonwealth of Puerto Rico.

(4) A debtor shall be deemed located at his place of business if he has one, at his chief executive office if he has more than one place of business, otherwise at this residence. If, however, the debtor is a foreign air carrier under the Federal Aviation Act of 1958, as amended, it shall be deemed located at the designated office of the agent upon whom service of process may be made on behalf of the foreign air carrier.

(5) A security interest perfected under the law of the jurisdiction of the location of the debtor is perfected until the expiration of four months after a change of the location of the debtor to another jurisdiction or until perfection would have ceased by the law of the first jurisdiction, whichever period first expires. Unless perfected in the new jurisdiction before the end of that period, it becomes unperfected thereafter and is deemed to

have been unperfected as against a person who became a purchaser after the change.

11 U.S.C. §547(b)(1988)

(b) Except as provide in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property -

(1) to or for the benefit of a creditor;

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

(3) made while the debtor was insolvent;

(4) made -

(A) on or within 90 days before the date of the filing of the petition; or

(B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and

(5) that enables such creditor to receive more than such creditor would receive if -

(A) the case were a case under chapter 7 of this title;

(B) the transfer had not been made; and

(C) Such creditor receive payment of such debt to the extent provide by the provisions of this title.

11 U.S.C. §547(g)(1988)

(g) For the purposes of this section, the trustee has the burden of proving the avoidability of a transfer under subsection (b) of this section, and the creditor or party in interest against whom recovery or avoidance is sought has the burden of proving the nonavoidability of a transfer under subsection (c) of this section.

STATEMENT

Metro Communications, Inc. ("Metro" or "Debtor") was a Maryland corporation with its chief executive office in Rockville, Maryland and was in the business of television and radio sports syndication. (The appendix filed with the Third Circuit, hereinafter referred to as "Record on Appeal"("ROA".) ROA 334A, 349A-350A, 1254A. In the winter and spring of 1984, Nelson L. Goldberg ("Goldberg") investigated acquiring Metro through a group of companies which he controlled because "his production companies could be used to produce the Metro sports games thus allowing for "vertical" integration and its attendance savings. ROA 1202A, 337A-338A, 525A.

On April 6, 1984, Metro was acquired by Total Communications, Inc. ("TCI") a wholly-owned subsidiary of Total Communication Systems Co.

("TCS"). ROA 338A, 470A-471A. TCI received a loan of $1.85 million to finance its purchase of the Debtor's stock from Mellon Bank. ROA 470A-471A, 726A, 1330A, 1344A-1359A. Metro also received a $2.3 million working capital loan under a line of credit agreement on the acquisition date. ROA 470A, 1340A-1345A, 1360A.

All of the Debtor's present and future assets served as collateral for this loan. ROA 471A, 765A-766A. TCI, TCS and Mass Communication Management, Ltd. ("MCM"), parent of TCS, guaranteed this loan. ROA 338A, 470A-473A, 1278-1314A, 720A-742A, 1330A-1360A. A security agreement between Metro and Mellon Bank, N.A. ("Mellon") was also executed on April 6, 1984. ROA 775A. UCC-1 financing statements, dated April 5, 1984, were filed in the appropriate state and local offices in Maryland. ROA 776A-779A.

Nelson Goldberg was the chief executive officer ("CEO") and chairman of the board of Metro, and was located in Pittsburgh, Pennsylvania. ROA 524A-525A, 418A, 398A. Mr. Goldberg personally sold advertising, made presentations to Metro's lenders, wrote millions of dollars worth of checks for Metro's acquisition rights, and made decisions on hiring and firing of Metro's key personnel. ROA 420A, 453A, 1109A-1114A, 546A, 1238A.

On July 12, 1984, "TCS and Metrosports" issued a joint press release, announcing that the two companies had been joined to form the nation's largest independent

rights/production company for collegiate sports. ROA 1204A. This "company" was to be headquartered out of TCS' New Kensington, PA location (just outside of Pittsburgh) and was to operate offices in Rockville, MD, New York, NY and Los Angeles, CA. ROA 1204A.

Metro's comptroller, at the time of the acquisition, William Eitze, left Metro in July, 1984. ROA 1254, 1032A. Prior to his departure, he was unaware of the financial dealings of Goldberg. ROA 1203A. After the departure of Eitze, all accounting of Metro was transferred to Pittsburgh. In August, 1984, Gail Schelat ("Schelat"), a former Mellon loan officer, became chief financial officer ("CFO") of TCS and Metro. ROA 339A, 389A, 1254A, 336A. Her work station was Pittsburgh. ROA 395A-396A, 405A. Once hired, Ms. Schelat and her staff handled all of the financial aspects of Metro's business, including receiving outside tax and audit assistance from the Pittsburgh office of Touche Ross. ROA 396A-397A, 400A. She also became extensively involved in the rights contract negotiations and her approval was required on all of Metro contracts, even those previously negotiated by Metro's president, Leonard Klompus. ROA 374A, 396A, 534A. Two of the major rights contracts executed after the acquisition, the Big East Conference and the Pacific-Ten Conference ("PAC-10") contracts, were negotiated and/or finalized by Schelat in Pittsburgh. ROA 867A-869A, 1085A-1090A, 1073A-1076A, 1055A. In addition, she executed the rights contract with the Naval Academy on October 3, 1984 and others during this period. ROA 844A-851A, 857A-864A, 1010-1012A.

On November 19, 1984, "TCS and Metrosports" issue another press release from Pittsburgh which announced that they were consolidating their operations and that Metrosports' headquarters, "previously in Rockville, Maryland", were being moved to Pittsburgh, effective on December 3, 1984. ROA 980A.

Metro's major bank account was with Mellon in Pittsburgh. ROA 1097A-1108A, 379A-380A, 1255A. Draws on the line of credit went into this account and checks for rights acquisition went out of this account. ROA 1098A, 1109A-1114A. Only Pittsburgh personnel were authorized signators on this account. ROA 1094-1096A.

All funds due Metro came to a Mellon Bank account in Pittsburgh via a "lock box" arrangement required by Mellon in August, 1984. ROA 402A-403A, 356A-358A, 744A-745A. This "centralized cash receipt and disbursement control" was required by Mellon as a condition of the working capital loan and a part of a $2.25 million "letter of credit loan" related to Metro's acquisition of PAC-10 broadcast rights. ROA 1343A, 1325A, 1010A-1012A. After establishing the lock box arrangement, all of Metro's customers were to be advised of the change in procedure for remittance of accounts. Metro's invoices then bore the notice: Please Remit To: TCS/METRO, P. O. BOX 371273, PITTSBURGH, PA 15251. ROA 1079A-1081A, 1010A.

Metro had fourteen employees prior to the acquisition; one-half of these employees were terminated

prior to September 1, 1984. ROA 1032A. At this time, Metro had four employees at the Maryland office, excluding their secretary and "go-fer." ROA 1031A-1032A. Metro's Maryland office had a profit-sharing bank account which was reduced to a zero balance on October 2, 1984. ROA 1146A.

Mellon filed UCC-1 financing statements in Pennsylvania in early February, 1985. ROA 780A-784A. Metro filed for Chapter 11 bankruptcy protection on March 15, 1985. ROA 1014A-1016A, ROA 18A-19A. The unsworn declaration under penalty of perjury which accompanied Metro's bankruptcy petition was signed by Metro's CFO, Schelat, and stated that Metro had been a resident of Pennsylvania for the preceding 180 days, or since September 15, 1984. ROA 1014A-1016A. The Debtor's bankruptcy schedules indicate assets of $15.4 million and liabilities of $23.8 million. ROA 1030A.

REASONS FOR GRANTING THIS PETITION

1. The Court of Appeals exceeded its appellate authority by ignoring this Court's interpretation of the "clearly erroneous" standard of review

This case does not present an obvious "conflict" on a "federal question". What the United States Court of Appeals for the Third Circuit ("the Circuit") did is, however, is in direct conflict with this Court's decisions and other of its decisions on the "clearly erroneously" standard of review[1]. This case presents an cogent example of what this Court has called the "vexing nature of the distinction between questions of fact and questions of law." *Pullman-Standard v. Swint*, 456 U.S. 273, 288, 102 S.Ct. 1781, 1790, 72 L.Ed.2d 66, 79 (1982); *citing Baumgartner v. United States*, 322 U.S. 665, 671, 64 S.Ct. 1240, 1244, 88 L.Ed. 1525, 1529 (1944).

The Circuit found that the location of a corporation's "chief executive office" under § 9103(c)(4) of the Uniform Commercial Code ("UCC") is a conclusion of law or, at least, a mixed question of law and fact. App. 14.

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[1] The Bankruptcy Court's determination of fact are subject to Review under the "clearly erroneous" standard of review. Federal Rule of Bankruptcy Procedure 8013. This Rule is modeled after Federal Rule of Civil Procedure 52(a). See Advisory Committee Note to Federal Rule of Bankruptcy Procedure 8013.

Two other United States Courts of Appeals ("the Circuits") have agreed that this determination was a "question of law", but only in the context of "undisputed facts."[2]

A. *"The tinsel and glitter of a legal precept"*[3] - Whether the determination of a "chief executive office" is a question of fact.

The Circuit acknowledged that the trial court used the correct legal standard, the "definition"[4] of "chief executive office" ("the term") found in the Advisory Committee Comment to § 9103(c)(4) of the UCC ("the comment").[5] App. 15.

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[2] *In re Golf Course Builders Leasing Inc.*, 768 F.2d 1167, 1169 (10th Cir. 1985); *In re J. A. Thompson & Son, Inc.*, 665 F.2d 941, 951, 33 UCC 356 (9th Cir. 1982).

[3] A phrase coined by former Chief Judge of the Circuit in *Trio Process Corp. v. L. Goldstein's Sons, Inc.*, 612 F.2d 1353, 1363 (3d Cir. 1980) (Aldisert, J., dissenting).

[4] The term "chief executive office is not defined in the UCC. See comment, *infra*

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[5] The Comments to the UCC were never enacted by the Pennsylvania legislature but the Pennsylvania Supreme Court gives substantial weight to the UCC Comments as evidencing the intended application of the Code. *In re Bristol Associates*, 505 F.2d 1056, 1058, note 2 (3d Cir. 1974). But see, *Miller v. Preitz*, 422 Pa. 383, 393, 221 A2d 320, 325, 3 UCC 557,

The Comment states, in part:

> Chief executive office, does not mean the place of incorporation, it means the *place from* which *in fact* the debtor *manages* the main part of his business operations. This is the place where person dealing with the debtor would normally look for *credit information* and is the appropriate place for filing. The term "chief executive office" is *not defined* in this Section or elsewhere in this Act. Doubt may arise as to which is the "chief executive office" of a multi-state enterprise, but it would be rare that there could be more than two possibilities. A secured party in such a case can easily protect himself at no great additional burden by filing in each possible place. This subsection states *a rule which will be simple to apply* in most cases, and which makes it possible to dispense with much burdensome and useless filing.
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(Emphasis added).

The phrase, "chief executive office" read in conjunction with the comment language suggest a simple, *factual* inquiry - Where is the top management of the

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562 (1966).

business?[6] The rationale for adopting this simple, objective test is that it mirrors business practice; most creditors would look to top management for credit information. Undoubtedly, top management has the financial information[7] to answer the typical businessman's inquiries - "Should I extend them credit?" or "How heavily are their assets encumbered?" or "Who will see I get paid?"

The drafters of the UCC did not define the term "chief executive office" because, presumably, they wanted the term to have it's "ordinary meaning".[8] If the

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[6] The Circuit stated "to require creditors of corporation to speculate as to who is calling the final shots is impractical and irrelevant." App. 18. The UCC test doesn't require *all creditors* to determine the "chief executive office" of a company. It requires *lenders* to determine the location, for filing purposes, *because other creditors will naturally look there* for financial information. The Circuit implied that Mellon had to speculate about "who was calling the final shots" of Metro. This concern is misplaced. The first two words, in Mellon's August 1984 Loan Committee documents under the heading "management", are "Nelson Goldberg", Metro's Pittsburgh-based CEO. ROA 1326A. Six Mellon Vice Presidents met with Metro's CEO and CFO in Pittsburgh on August 22, 1984 and discussed Metro's financial performance. ROA 1216A, 1206A-1213A. See also, *inter alia*, ROA 1201A-1202A.

[7] The Circuit conceded that "The evidence does show that accounting and financial services were consolidated in the Pittsburgh office shortly after the leveraged buyout" but found "the location of these services is not determinative. " App. 18, note 1.

[8] None of three words in this term are legal "terms of art"; "executive" is defined in Black's legal dictionary but only to distinguish executive branch of government from the legislative and judicial branches.

drafters wanted to give the term a legal or a technical meaning, they would have defined the term[9]. They contemplated a simple test[10] and chose a term every businessman can understand.

The "clearly erroneous" standard embodied in Rule 52(a)[11] does not, itself, furnish guidance with respect to distinguishing law from fact. *Pullman-Standard v. Swint*, 456 U.S. 273, 288, 102 S.Ct. 1781, 1790, 72 L.Ed.2d 66, 79 (1982). Many Circuits, including the Third Circuit, have based the distinction between "questions of law" and "questions of fact" on whether a "legal precept is implicated", whether a "legal standard" must be applied or whether a "legal concept" necessarily involved in making such a finding. *Universal Minerals, Inc. v. C.A. Hughes & Company*, 669 F.2d 98, 102-103 (3d Cir. 1981).

A layman doesn't have to employ a legal standard to determine where is the "chief executive office" of a business; he has to make a simple, factual inquiry. The

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[9] There are over one hundred sixty-five (165) terms specifically defined in Pennsylvania's version of the UCC.

[10] The comment states: "This subsection states a rule that will be simple to apply in most cases."

[11] Federal Rule of Civil Procedure 52's bankruptcy equivalent is Federal Rule of Bankruptcy Procedure 8013. The pertinent text of Rule 8013 is identical to Rule 52(a).

drafters of the UCC chose a nontechnical test[12] which a businessman could understand[13].

The drafters of the UCC intended the determination of "chief executive office" of a company to be a question of fact.[14] The Circuit has dressed the UCC's "realistic, practical inquiry"[15] in the "tinsel and glitter of a legal precept"; it "snipp(ed) at the facts by contriving artificial legal precepts"[16].

B. Whether the trial court's determination of the Debtor's "chief executive office" was clearly erroneous?

***If* the determination of "chief executive office" of a company is a "question of fact", the further question**

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[12] This Court has found that the use of a nontechnical statutory term can indicates a factual inquiry. *Commissioner of Internal Revenue v. Duberstein*, 363 U.S. 278, 289, 80 S.Ct. 1190, 1199, 4 L.Ed.2d 1218, 1227 (1960) (construing the term "gift"in the Internal Revenue Code).

[13] The Circuit acknowledged that the UCC "envisions a realistic test" which was a "practical ... inquiry". App. 16.

[14] Use of term "in fact" in the comment suggests no other reasonable construction or interpretation. The comment states in part: "Chief executive office ... means the ***place from*** which ***in fact*** the debtor ***manages***..."

[15] See note 13, supra.

[16] A phrase used in *Trio Process Corp. v. L. Goldstein's Sons, Inc.*, 612 F.2d 1353, 1362 (3d Cir. 1980) (Aldisert, J., dissenting).

for this Court is not whether the interpretation of the facts by the Circuit was clearly erroneous, but whether the trial court's finding was clearly erroneous. ***Anderson v. Bessemer City, N.C.***, 470 U.S. 564, 577, 105 S.Ct. 1504, 1513, 84 L.Ed.2d 518, 530 (1985); ***McAllister v. United States***, 348 U.S. 19, 20-21, 75 S.Ct. 6, 7-8, 99 L.Ed. 20, 24 (1954).

The Circuit did not dispute or find insufficient[17] the trial court's factual findings that, *inter alia*,:

(1) the CEO of the company was Nelson L. Goldberg and he was located in Pennsylvania (App. 70);
(2) the CFO of the company was Gail Schelat and she was located in Pittsburgh (App. 70);
(3) all funds due the company came to Pittsburgh, by early September, 1984 (App. 72, 59-60); and
(4) all accounting and financial services of the company were consolidated in Pittsburgh shortly after the acquisition (App. 71)[18](collectively "the unchallenged factual findings").

The trial court's finding that the "chief executive

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[17] The Circuit failed to employ its own standard that, to the extent, the trial court made findings on disputed issues of fact our standard of review is whether there is sufficient evidence to support those findings. *Krasnov v. Dinan*, 405 F.2d 1298, 1302 (3d Cir. 1972); *Cooper v. Tard*, 855 F.2d 125, 126 (3d Cir. 1988); *Cox v. Keystone Carbon Co.*, 894 F.2d 647, 650 (3d Cir. 1990).

[18] The Circuit endorsed this finding. App. 18, note 1. This finding alone suggests Pittsburgh was the proper place to look for *credit information*.

office" of Metro was in Pittsburgh is undeniably "plausible" in light of the unchallenged evidence. The Circuit viewed the evidence differently, "but where there are two permissible views of the evidence, the fact finder's choice between them cannot be clearly erroneous". *Anderson v. Bessemer City, N.C.*, 470 U.S. 564, 574, 105 S.Ct. 1504, 1511, 84 L.Ed.2d 518, 528 (1985).

Even if the trial court made particular erroneous factual findings, the proper course in this case would have been remand. Where findings are infirm because of an erroneous view of the law, a remand is the proper course unless the record permits only one resolution of the factual issue. *Pullman-Standard v. Swint*, 456 U.S. 273, 291, 102 S.Ct. 1781, 72 L.Ed.2d 66, 81-82 (1982) citing *Kelley v. Southern Pacific Co.* 419 U.S. 318, 331-332, 95 S.Ct. 472,42 L.Ed.2d 498 (1974). Given the four unchallenged factual findings, the record does not *fairly* permit the only resolution of the issue in Mellon's favor.[19]

The Circuit criticized the trial court's decision on five grounds. Each attack is premised on either a misapprehension of the *nontestimonial* evidence, the trial court's opinion or the UCC test. None of these alleged

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[19] The Circuit's failure to remand under these circumstances constitutes a departure from the "accepted and usual course of judicial proceedings", making exercise of this Court's power of supervision necessary.

"errors" alter the record[20] so as to "permit only one resolution of the issue of the location Metro's "chief executive office".

The Circuit concluded that the trial court erred in requiring Mellon prove that its security interest was *not* a voidable preference under § 547 of the Bankruptcy Code in order to establish its secured status.[21] App. 15. The trial court did not render such a holding.[22] The District Court specifically found the Committee had the burden on the § 547 (b) issues in accord with § 547 (g) of the Bankruptcy Code. App. 49.

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[20] The Circuit's discussion of *specific* evidence is limited; and includes 1). memorandum between Klompus and Goldberg (Metro's Maryland Based President and its Pittsburgh based CEO); App. 17: ROA 1033A-1064A; 2). an October 5, 1984 letter contract (executed by Metro's Pittsburgh based CFO, Gail Schelat); App. 18-19; ROA 867A-869A; 3). a tax form filed in early 1985 (prepared and executed in Pittsburgh); App. 19; ROA 802A,803A, 811A, 386A-387A, 397A; and 4). two "press releases, one dated July 12, 1984 (issued from New York City), and one dated November 19, 1984 (issued from Pittsburgh); App. 19-20; ROA 1204A-1205A, 980A. Much of this evidence supports the petitioner, however, it represents very small percentage of the one hundred fifty-two trial exhibits (655 pages) and *none of the testimonial evidence* from the eight witnesses.

[21] The Circuit also found this "error" "materially permeated its factual findings." App. 15. The Circuit did not explain how this "permeation" occurred nor which findings were effected.

[22] The trial court did not mention the burden on the elements of § 547(b) of the Bankruptcy Code. The Circuit apparently equated this omission with lack of knowledge; a doubtful equation considering how much of a bankruptcy court's time involves "preference" litigation. The trial court did question whether Mellon was ever properly perfected by it's Maryland UCC filings. App. 57, note 5.

The Circuit thought that the trial court concluded Metro came under the control of its parent corporation, TCS[23], *and thus* Metro's headquarters became those of TCS. App. 16. The trial court made no such causal conclusion. The trial court examined the relationship between Metro's Maryland based president, Leonard Klompus, and its Pittsburgh based CEO, Nelson Goldberg[24] by reviewing memorandum[25] between these individuals and concluded that the Metro's Maryland office wasn't autonomous and was, in fact, managed *from Pittsburgh*. App. 61-63, 69-70.

The Circuit also concluded that "the *main part* of Metro's activities was the acquisition of syndication rights and the sale of advertising; this activity remained centered in the Rockville office until it was closed in December of 1984." App. 18. This conclusion is

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[23] TCS was the grandparent of Metro, not the parent. ROA 338A, 393A. TCI was a holding company formed for the acquisition of Metro by TCS and was the parent of Metro. ROA 248A, 338A.

[24] Nelson Goldberg was also Chairman of the Board of Directors of Metro and was the majority shareholder in the companies that owned Metro after April 6, 1984. ROA 397A, 785A, 470A.

[25] The Circuit thought that these memoranda were *intercorporate* (between, TCS and Metro ... "affiliated corporations") rather than *intracorporate* (between two officers of Metro) App. 17. The subject matter of the these documents concerned Metro business. ROA 1033A-1064A. Leonard Klompus had no management role in TCS.

neither factually[26] nor legally correct[27].

The Circuit concluded that two press releases, one dated July 12, 1984[28] and one dated November 19, 1984[29] of "TCS/Metrosports" were highly probative[30] in determining the Debtor's "chief executive office". These

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[26] The only specific evidentiary support for the Circuit's conclusion that acquisition of rights was centered in Maryland seems to be the October 5, 1984 contract which was executed by Metro's Pittsburgh based CFO, Gail Schelat. This letter agreement was (mis)directed to the Maryland office. *See* note 20, *supra*. There was evidence that both Klompus and Goldberg sold advertising. ROA 420A.

[27] Even if the main part of Metro's business was centered in Maryland, the UCC test is where is the main part of the business *managed from*. *See* text of UCC comment at page 13, *supra*.

[28] This release states that TCS and *Metrosports* "announced today.... have joined to form the ...company....TCS/Metrosports will be headquartered out of TCS" New Kensington, PA location (just outside of Pittsburgh) and will operate offices in Rockville, MD ... Goldberg will serve as chairman of the board and chief executive officer". ROA 1204A-1205A.

[29] This release was issued from Pittsburgh and states: "Merged in June, TCS/Metrosports said today that the Metrosports headquarters, previously in Rockville, Maryland, are being moved...effective December 3." ROA 980A.

[30] The Circuit called the July release "the only relevant evidence in support of the court conclusion." It called the November release "the most telling piece of evidence". App. 19.

releases are factually inaccurate[31], inconclusive[32] and subjective pronouncements of an ill-defined entity[33], not the Debtor[34]. These subjective statements are arguably irrelevant[35], the weight to be given them a matter for the trial court, particularly when inconsistent with other pronouncements of the Debtor[36].

The Circuit also concluded "much evidence readily available to creditors" demonstrates Metro's

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[31] There was no evidence presented that TCS and *Metrosports* were legally merged, TCS was the grandparent of Metro Communications, Inc. Metrosports stationary portrayed Metrosports as *a division of Metro Communications, Inc.* ROA 838A, 841A, 852A, 893A, 972A. The CEO and CFO of the companies were the same, Pittsburgh based, personnel. ROA 525A, 1204A, 336A, 339A.

[32] Assuming TCS and Metrosports were never merged, and that *Metrosports was a division of Metro Communications, Inc.*, the most these releases can show is that a division of the Debtor moved back to Pittsburgh on or before December 3, 1984,

[33] The Circuit called "TCS/Metrosports" a "joint venture" rather than grandparent and grandchild. The only basis for calling this relationship a "joint venture" seems to be the (inaccurate) language of the press releases which indicates the two "companies" were "merged."

[34] Neither press release was issued from Maryland, the place the Circuit concluded was the "chief executive office" of the Debtor. ROA 1204A-1205A, 980A.

[35] *See* note 46, *supra*.

[36] The Debtor's CFO signed a declaration under penalty of perjury which accompanied the Debtor's bankruptcy petition. It alleges that the Debtor has resided in the Western District of Pennsylvania for the preceding six months, or since September 15, 1984. ROA 1014A-1016A.

headquarters were in Maryland until December of 1984. The Circuit refers to contracts, tax forms and (*"Metrosports"*) stationary. There was no evidence presented that Metro's contracts[37] and tax forms[38] were "readily available to creditors", nor do these documents support the Circuit's conclusion[39]. The Circuit ignored undisputed evidence that most of Metro's "rights" creditor's were paid from Metro's Pittsburgh bank account at Mellon.[40]

Circuit's criticism of the trial court is at worst, ill-founded; at best, a matter of differing weight given to a handful of documents. Neither view warrants reversal because "if the trial court's account of the evidence is plausible in light of the record, viewed in its

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[37] The October 5, 1984 letter contract referred by the Circuit was *executed by Metro's Pittsburgh based CFO, Gail Schelat.* ROA 867A-869A. So were the Metro's contracts executed with the Naval Academy, Virginia Tech, the Big East Conference *and Mellon.* ROA 844A-851A; 857A-864A; 867A-869A; and 1010A-1012A.

[38] The tax forms were prepared and signed by Diane Acre who worked in Pittsburgh. ROA 386A-387A, 397A, 790A, 793A, 799A, 801A, 802A, 803A, 808A, 809A, 811A.

[39] *See* notes 37-38, *supra.* The stationary listed Maryland as "headquarters" of *Metrosports* and portrayed Metrosports as *a division of Metro Communications, Inc.* ROA 838A, 841A, 852A, 893A, 972A.

[40] Metro's CEO and CFO signed checks totalling in excess of five million, three hundred thousand dollars ($5,300,000.00) to "rights" creditors between May 15, 1984 and September 1, 1984. On the face of these checks was: "Metro Communications, Inc. 890 Constitutional Boulevard, New Kensington, PA 15068." ROA 1109A-1114A.

entirety[41], the Court of Appeals may not reverse it even though convinced that, had it been sitting as a trier of fact, it would have weighed the evidence differently." *Amadeo v. Zant*, 486 U.S. 214, 223, 108 S.Ct. 1771, 1777, 100 L.Ed 2d 249, 261 (1988); *see also Inwood Laboratories v. Ives Laboratories*, 456 U.S. 844, 857-858, 102 S.Ct. 2182, 2190, 72 L.Ed.2d 606, 618 (1982).

II. Review of these questions are important, both to the lending community and the courts.

A. The special consequences to the lending community

If this case has special importance to warrant this Courts review, it because of commercial context of decision and the confusion this decision may engender. If a debtor has offices in two or more states, the perfection of a lender's security interests in the debtor's "accounts" and "general intangibles" rests on the determination of the debtor's "chief executive office".[42]

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[41] The record in the Circuit consisted of one thousand three hundred seventy-five (1,375) pages, including two days of testimony from eight witnesses.

[42] *See* § 9103(c)(2)-(c)(4) of the UCC at page 3-4, *supra*.

The Circuit has turned the simple, objective test of the UCC into an ill-defined inquiry[43] which discounts the "locus of financial management"[44] and emphasizes "subjective considerations", i.e., the pronouncements of the "debtor"[45]. The emphasis on "subjective considerations" has little foundation in law[46] or policy[47]. The Circuit's decision, which discounts the "locus of financial management", is in conflict with other Circuit

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[43] The Circuit held "to require creditors of a corporation to speculate as to who is calling the final shots is impractical and irrelevant". App. 18. "Who is calling the final shots" is probably as good a definition of "chief executive officer" as most.

[44] The Circuit concluded "the evidence does show that accounting and financial services were consolidated in the Pittsburgh office...the location of these services is *not determinative*." App. 18, note 1.

[45] *See* notes 28-34, *supra*.

[46] A creditor is not entitled to previil on the "chief place of business" issue merely because he relied on representations of the debtor as to the latter's "chief place of business." It has long been the rule that creditors have a duty to acquaint themselves with the facts necessary to enable them to file in accordance with the commercial codes. *In re J. A. Thompson*, 665 F.2d 941, 950 (9th Cir. 1982).

[47] Reliance on pronouncements of the debtor will be dangerous to the lending community because it is the debtor who, at least in the slide to bankruptcy, has the most to gain from avoiding his lender's security interest.

decisions.[48]

The potential for confusion by this decision is immense in an area of law where certainty is a primary concern[49].

B. "Neither reason nor empowerment"[50] - The general consequences of this decision to the Courts

The "clearly erroneous" standard of review is based on the trial court's position and experience; it is supported by sound policy and tradition. It's rationale is not only deference to the finder of fact because of his superior position to make determinations of credibility, it is based on the principle that, with experience as a fact finder, comes expertise. Duplication of the trial judge's

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[48] *In re Golf Course Builders Leasing Inc.*, 768 F.2d 1167, 1170-1171 (10th Cir. 1985); *In re J. A. Thompson & Son, Inc.*, 665 F.2d 941, 950, 33 UCC 356, 366-67 (9th Cir. 1982); *See also*, *In re Astrocade*, Inc., 31 Bankr. 245, UCC 1391, 1394-99 (S.D.Ohio 1983); *Davidson v. Smith Canadian Peat, Inc.*, 163 Ga. App. 367, 294 S.E.2d 582, 34 UCC 1376, 1378 (1982); *In re Swartz*, 62 B.R. 88, 2 UCC2d 1689 (D.Neb. 1986).

[49] The Comment to §9101 of the UCC states: "The aim of this Article is to provide a simple and unified structure within which the immense variety of present day secured financing transactions can go forward with less cost and *greater certainty*.

[50] A phrase employed by former Chief Judge of the Circuit in *Trio Process Corp. v. L. Goldstein's Sons, Inc.*, 612 F.2d 1353, 1362 (3rd Cir. 1980) (Aldisert, J., dissenting).

efforts in the court of appeals would very likely contribute only negligibly to the accuracy of fact determination at a huge cost in diversion of judicial resources. *Icicle Seafoods, Inc. v. Worthington*, 475 U.S. 709, 715, 106 S.Ct. 1527, 1530, 89 L.Ed. 2d 739, 745 (1986) *quoting Anderson v. Bessemer City*, 470 U.S. 564, 574-575, 105 S.Ct. 1504, 1512, 84 L.Ed.2d 518, 529 (1985).

The consequences of ignoring the "clearly erroneous standard" include:

(1) the number of appeals are increased[51];
(2) there is a decreased likelihood of settlement[52];
(3) the confidence of litigants and the public in the decisions of trial courts are impaired[53]; and
(4) the traditional role of trial courts [54] and it's morale are diminished[55];

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[51] Wright, *The Doubtful Omniscience of Appellate Courts*, 41 Minn L. Rev. 751, 779 (1957).

[52] Nangle, *The Ever Widening Scope of Fact Review in Federal Appellate Courts*, 59 Wash. U.L.Q. 409, 427 (1980).

[53] *Pendergrass v New York Life Insurance Co.*, 181 F.2d 136, 138 (8th Cir. 1950).

[54] *Trio Process Corp. v. L. Goldstein's Sons, Inc.*, 612 F.2d 1353, 1364 (3d Cir. 1980) (Aldisert, J., dissenting).

[55] Nangle, *The Ever Widening Scope of Fact Review in Federal Appellate Courts*, 59 Wash. U.L.Q. 409, 427 (1980).

The impact on the trial courts, themselves, is the most far reaching of these consequences because their future work has to be effected[56]. Two judges in this case saw their work was brushed aside with some "glitter and tinsel". Indifference, resentment or even reactionary artifice would be natural reactions to the "broadcast of the unwarranted belief that appellate judges are better qualified than trial judges to decide what justice requires"[57]. There is "neither reason nor empowerment"[58] for the Circuit's invasion into the jury box.

If the Circuits do not give deference to the facts found by the trial courts, *only this Court* can maintain the traditional balance between the trial courts and the appellate courts.

CONCLUSION

The petition for certiorari should be granted and this Court should exercise its supervisory power.

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[56] Trial courts are not rewarded for the long, often tedious hours of watching and reviewing the mosaic of evidence. They have little incentive to find facts when they see the facts retried on appeal. The District Court, acting in an appellate role, is not rewarded for his "deference" to the "special province" of the trial court.

[57] *Trio Process Corp. v. L. Goldstein's Sons, Inc.*, 612 F.2d 1353, 1364 (3d Cir. 1980) (Aldisert, J., dissenting). The Circuit purported to "re-exaxmin(e) the evidence with more illumination that enjoyed by the bankruptcy court.." App. 16.

[58] Id at 1362.

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January 18, 1992

APPENDIX

Filed September 25, 1991

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

NOS. 91-3105 and 91-3160

MELLON BANK, N.A.,
Appellant in No. 91-3105

vs.

METRO COMMUNICATIONS, INC.
t/a METROSPORTS, debtor-in possession,
and THE PACIFIC 10 CONFERENCE

vs.

THE COMMITTEE OF UNSECURED CREDITORS
Intervenor in District Court

Grant Street National Bank (in liquidation).

Appellant in No. 91-3160

Appeal from the United States District Court
for the Western District of Pennsylvania
District Court No. 89-00782

Argued July 8, 1991
Before: STAPLETON, HUTCHINSON, and ROSENN,
Circuit Judges
Opinion Filed September 25, 1991

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OPINION OF THE COURT

ROSENN, Circuit Judge.

This appeal, arising in the context of a failed leveraged buyout, had its roots in the congenial climate of mergers and acquisitions that beguiled corporate America during the decade of the nineteen-eighties. The appeal raises important questions regarding a bankruptcy trustee's avoidance powers under 11 U.S.C. §§ 547(b) and 548(a)(2) of the bankruptcy code. The debtor is Metro Communications (Metro), the corporation acquired in the leveraged buyout. Mellon Bank, N.A. (Mellon or Bank) financed the acquisition; Mellon lent the acquiror 1.85 million dollars to purchase all of the capital stock of the target corporation, Metro. Metro guaranteed and secured the acquisition loan with substantially all of its assets. Simultaneously with the leveraged buyout, Mellon extended a 2.3 million dollar credit line to Metro. At a later date, Mellon extended another 2.25 million dollars to Metro in the form of letters of credit. These loans were also collateralized by the security interest in substantially all of Metro's assets. Within a year of the leverage buyout, Metro filed a bankruptcy petition under chapter 11.

The bankruptcy court held that Mellon's security interest in the three loans constituted a voidable preference under 11 U.S.C. § 547(b), finding that Mellon's security interest lapsed because it failed to re-file financing statements within four months of Metro's change in the location of its headquarters and that the

refiling of the financing statements at the debtor's new location during the ninety day period preceding the filing of the bankruptcy petition constituted a voidable preference. Furthermore, the court held that Metro's guaranty of the acquisition loan and the execution of a security interest in connection therewith constituted a fraudulent conveyance under 11 U.S.C. § 548(a)(2). We reverse.

I.

Metro Communications, also known as Metrosports (Metro), the debtor, had been in the business of television and radio sports syndication for about ten years prior its bankruptcy. Metro, incorporated in Maryland in 1972, originally had its headquarters in Rockville, Maryland. Its business included acquiring the rights to broadcast sporting events, contracting with radio and television stations for such broadcasts, and selling rights to advertise during the broadcasts.

In April of 1984, Metro's stockholders sold all of their capital stock to Total Communications, Inc. (TCI), a wholly owned subsidiary of Total Communications Systems Co. (TCS). The principals of TCI created it solely for the purpose of acquiring the stock of Metro and becoming its sole shareholder. TCS, in turn, is the wholly owned subsidiary of Mass Communications and Management, Ltd. (MCM). These affiliated corporations were in the business of syndicating and producing television programs of college athletic events. TCS owned and operated mobile television production studios

used in the broadcasting of athletic events nationally.

TCI acquired Metro for the purpose of creating a synergy of complimentary services; Metro, as the buyer and seller of broadcasting rights, contracted regularly with companies, such as TCS, to produce and broadcast the athletic events. The two companies, TCS and Metro, developed a joint marketing concept known as TCS/Metro, and issued press releases and other promotional materials which stressed that the companies were working as a joint venture, joining their strengths and "working as a team."

To finance the purchase of the Metro stock, TCI borrowed $1,850,000 from Mellon on April 6, 1984. On the same day, Mellon loaned Metro $2,300,000 for use as working capital under a line of credit agreement. Pursuant to guaranty and suretyship agreements dated April 6, 1984, TCI guaranteed the repayment of the loan to Metro. Metro guaranteed the repayment of the loan to TCI, and TCS and MCM jointly guaranteed the repayment of both loans.

In addition to the guarantees, Metro entered into an agreement dated April 6, 1984, with Mellon Bank wherein Metro conveyed to the Bank a security interest in substantially all of Metro's property, including its general intangibles and accounts receivable. The security agreement provided that the collateral secured "all . . . indebtedness, obligations and liabilities of [Metro] to the Bank, now or hereafter existing, including but not limited to those arising under the Guaranty, and those arising under the Metrosports Loan Agreement . .

On September 7, 1984, Metro and Mellon entered into a Letter of Credit Agreement to finance Metro's purchase of broadcast rights for the PAC-10 Conference football season. The Letter of Credit Agreement provided that Mellon's reimbursement rights were secured under the April 6, 1984 security agreement between Mellon and Metro and guaranteed by TCI, TCS, and MCM. Between December 18, 1984 and January 2, 1985, Mellon disbursed the full $2,250,000 face amount of the letters of credit in response to the PAC-10's drawing requests. The following chart summarizes the loans received and guaranties made by Metro:

TRANSACTION	DATE	AMOUNT
Guaranty of Acquisition Loan	4/6/84	$1,850,000
Working Capital Line of Credit	4/6/84	$2,300,000
PAC-10 Letter of Credit	12/18/84	$2,250,000

The Bank perfected its security interests in the collateral pledged by Metro by filing UCC-1 financing statements in the Maryland State Department of Assessment and Taxation on April 9, 1984 and the Clerk's Office of the Circuit Court of Montgomery County, Maryland, on April 17, 1984. The Bank filed additional UCC-1 financing statements in the appropriate

offices in Pennsylvania on December 3, 1984.

On March 12, 1985, PAC-10 filed a complaint against Metro, TCS, and various related entities in the United States District Court for the Northern District of California, alleging breaches of various agreements covering the broadcasting of PAC-10 basketball and football games. Simultaneously with the filing of the complaint, PAC-10 obtained an *ex-parte* order which permitted pre-judgment attachment of Metro's assets. Pursuant to the order, PAC-10 attached certain outstanding accounts receivable of Metro. Three days later, on March 15, 1985, Metro filed a petition for reorganization under Chapter 11 of the Bankruptcy Code.

On January 30, 1986, the Bank filed an adversary proceeding against Metro and PAC-10 to determine the validity, priority, and extent of the Bank's security interest and to ascertain the parties' respective rights in an escrow account which PAC-10 had attempted to attach. The Official Unsecured Creditor's Committee ("the Committee") intervened, claiming that the Bank had received preferential transfers pursuant to 11 U.S.C. § 547(b) and that a fraudulent conveyance had occurred pursuant to 11 U.S.C. § 548(a)(2).

PAC-10, Metro and the Bank have agreed to settlement of their disputes over the escrow account and have presented their settlement to the bankruptcy court for approval. The bankruptcy court has stated that it will defer ruling on the proposed settlement until this appeal is resolved.

Prior Court Proceedings

After a two-day bench trial, the bankruptcy court on February 10, 1989, filed an opinion and order holding that the Bank's security interest in Metro's assets was voidable under 11 U.S.C. § 547(b) and that Metro's guaranty of the acquisition loan and the grant of the security interest was a fraudulent conveyance under 11 U.S.C. § 548(a)(2). *In re Metro Communications, Inc.*, 95 B.R. 921 (Bankr. W.D. Pa. 1989). The court ordered the Bank and Metro to file an accounting, showing all amounts subject to disgorgement. In October of 1988, after the bench trial but before the bankruptcy court filed its decision, Mellon assigned all its claims against Metro to Grant Street National Bank (GSNB), which is now in liquidation. On February 17, 1989, counsel for Mellon and GSNB (together, the Banks) filed a motion to amend the February 10, 1989 order under Rule 59(e) of the Federal Rules of Civil Procedure. That motion, filed on behalf of GSNB as successor in interest to Mellon, sought to exclude from the scope of the bankruptcy court's order payments made by Metro to Mellon with respect to loans made directly to Metro from Mellon more than 90 days prior to Metro's bankruptcy filing.

On February 27, 1989, GNSB filed its Notice of Unconditional Assignment of Claim to it by Mellon Bank. The bankruptcy court issued a second order on April 4, 1989, permitting GSNB to intervene in the adversary proceeding as an additional plaintiff and amending its February 10, 1989 order in accordance with the relief requested. On April 10, 1989, the Banks filed

their notice of appeal in the district court.

In a third order, dated May 15, 1989, the bankruptcy court expressly directed the entry of a final judgment on its prior order of February 10, 1989, as amended April 4, 1989, and certified it under Fed. R. Civ. P. 54(b) for appeal to the district court, stating that certification was in the interest of fostering a speedy, economical and orderly resolution of the appeal. The Banks filed a supplementary joint notice of appeal within 10 days after the docketing of this May 15 order.

On February 12, 1991, the district court entered an order affirming the bankruptcy court's rulings in all respects except for the award of pre-judgment interest. Mellon and GSNB each appealed to this court; we consolidated the appeals.

II.

A. *Jurisdiction*

The threshold question that must be answered is whether this court possesses jurisdiction to hear this appeal. The Committee argues that both this court and the district court lacked jurisdiction because of the failure to file a timely appeal. The Committee contends that the motion to amend judgment filed on February 17, 1889, did not serve to toll the ten-day period for filing a notice of appeal from the bankruptcy's February 10, 1989 order. The Committee claims that, consequently, the notice of appeal filed on April 19, 1989, was untimely.

The Committee alleges that the motion to amend was ineffective because GSNB filed it as a successor in interest to Mellon Bank. The Committee argues that GSNB cannot be considered a "party in interest" because it filed its notice of unconditional assignment with the bankruptcy court only after filing the motion to amend and also after the expiration of the ten-day appeal period.

The Banks correctly point out that this argument turns on the mistaken premise that the February 10, 1989 order constituted a final judgment and thus the ten-day appeal period began on that date. However, the February 10, 1989 order was not a final judgment. Mellon Bank instituted the original suit against PAC-10. The February 10th order did not purport to settle Mellon's claims as to PAC-10 and thus the judgment was not final as to all claims and as to all parties as required for appeal. *See Andrews v. United States*, 373 U.S. 334, 340 (rule of finality requires that the judgment be final as to all parties as well as causes of action to be appealable). Indeed, the bankruptcy court has deferred ruling on the settlement of Mellon, Metro, and PAC-10 pending the resolution of this appeal.

The February 10th order became appealable only when the bankruptcy court certified it pursuant to Federal Rule of Procedure 54(b) (made applicable to bankruptcy proceedings by Bankruptcy Rule 7054). The Banks filed a supplementary joint notice of appeal within ten days of the bankruptcy court's certification. Thus, regardless of whether GNSB had standing to file a

motion to amend the February 10th order, the district court, as well as this court, possess jurisdiction to hear the appeal.

B. *Voidable Preference Under Section 547*

The bankruptcy court concluded that Mellon Bank's security interest supporting the three loans - the acquisition loan, the working capital loan, and the letter of credit loan - constituted a voidable preference under 11 U.S.C. § 547(b). The court determined that the perfection of this security interest constituted a voidable preference because Mellon untimely refiled its financing statements in the debtor's new location.

The purpose of section 547 of the Bankruptcy Code is to prevent preferences of certain creditors so that the debtor's assets may be fairly distributed among all creditors, not merely those that are favored. *Kapela v. Newman*, 649 F.2d 887 (1st Cir. 1981). Section 547 provides, in relevant part, that:

> the trustee may avoid any transfer of an interest of the debtor in property -
>
> (1) to or for the benefit of a creditor;
>
> (2) for or on account of an antecedent debt owned by the debtor before such transfer was made;
>
> (3) made while the debtor was insolvent;

(4) made -

(A) on or within 90 days before the date of the filing of the petition...

(5) that enables such creditor to receive more than such creditor would receive if -

(A) the case were a case under chapter 7 of this title;

(B) the transfer had not been made; and

(C) such creditor received payment of such debt to the extent provided by the provisions of this title.

11 U.S.C. § 547(b). Assuming, for the moment, that the perfection of a security interest constitutes a transfer of an interest of the debtor in property, the crucial issue in the present case is whether the perfection occurred within the 90 day period prior to the filing of the bankruptcy petition.

Whether the transfer occurred within the 90 day period turns on whether Mellon untimely refiled its security interest in Pennsylvania. 13 Pa. C.S.A. § 9103(c) governs the perfection of security interests in multi-state transactions. In pertinent part, it provides:

(4) A debtor shall be deemed located...at his chief executive office if he has more than one place of business . . .

> (5) A security interest perfected under the law of the jurisdiction of the location of the debtor is perfected until the expiration of four months after a change of the location of the debtor to another jurisdiction or until perfection would have ceased by the law of the first jurisdiction, whichever period first expires. Unless perfected in the new jurisdiction before the end of that period, it becomes unperfected thereafter and is deemed to have been unperfected as against a person who became a purchaser after the change.

The parties agreed that at the time of the leveraged buyout, Metro had its chief executive office in Rockville, Maryland. Mellon filed in the appropriate offices in Maryland in April of 1984, thus perfecting its security interest. The issue is whether Mellon's refiling in Pennsylvania was within four months of the Metro's transfer of its chief executive office to Pittsburgh.

If the debtor moved its headquarters to Pennsylvania on or after October 5, 1984, Mellon's security interest in Metro's assets remained perfected. If the change of the chief executive office occurred prior to October 5, 1984, the lien of Mellon's statements would have lapsed, and the filing statements in Pennsylvania would constitute a reperfection rather than a continuation of the earlier perfected status. If the refilings constituted a reperfection, that new perfection occurred within the 90 day period of section 547 and is thus vulnerable to attack.

The bankruptcy court determined that Metro moved its office "at least some time before October, and most apparently by late August." This court reviews the bankruptcy court's findings of fact under a clearly erroneous standard, whereas its conclusions of law are subject to plenary review. *In re Jersey City Medical Center*, 817 F.2d 1055, 1059 (3rd Cir. 1987). However, mixed questions of law and fact, such as the ultimate determination of when and what constituted a relocation of the chief executive offices of a corporation, is a conclusion of law or, at least, a mixed question of law and fact. We are therefore not limited to the "clearly erroneous" standard but must exercise a mixed standard of review. We accept the trial court's finding of historical or narrative facts unless clearly erroneous, but exercise "plenary review of the trial court's choice and interpretation precepts to the historical facts." *Universal Minerals, Inc. v. C. A. Hughes & Co.*, 669 F.2d 98, 101-02 (3rd Cir. 1981).

The preliminary and significant legal question that must be discussed is the allocation of the burden of proof. The bankruptcy court explicitly placed the burden of proving that Mellon's security interest did not constitute a voidable preference under section 547 on Mellon. The court reasoned that because Mellon's complaint asserted its secured status, it therefore had the burden of proving the same by the preponderance of the evidence. Although this statement is in and of itself correct, the bankruptcy court failed to realize that Mellon had satisfied that burden of proof by showing it properly filed financing statements made in Pennsylvania prior to the debtor's filing under chapter 11. *See* 11

U.S.C. § 502(a).

The bankruptcy court erred in holding that Mellon had to prove that its security interest was not a voidable preference under section 547 in order to establish its secured status. This ruling is in direct contravention with the allocation of the burden of proof statutorily provided for in section 547(g) which states that "*the trustee has the burden of proving the avoidability of a transfer under subsection (b) of this section.*" 11 U.S.C. § 547(g) (West Supp. 1991) (emphasis supplied). The bankruptcy court's erroneous legal conclusion that Mellon had the burden of proof to sustain the validity of its security interest under section 547 materially permeated its factual findings.

Turning to the bankruptcy court's factual findings as to when Metro moved its chief executive office, it appears that the court utilized the correct definition. The Official Comments to § 9-103 explains that the "chief executive office does not mean the place of incorporation; it means the place from which in fact the debtor manages the main part of his business operations. This is the place where persons dealing with the debtor would normally look for credit information." Courts have used this language to develop a two-part test to determine the location of a debtor's chief executive office:

> (1) from which place does the debtor manage the main part of its business operations; and
>
> (2) where would creditors reasonably be

expected to search for credit information?

In re Golf Course Builders Leasing, Inc., 768 F.2d 1167, 1170 (10th Cir. 1985); *In re J. A. Thompson & Sons, Inc.*, 665 F.2d 941, 949 (9th Cir. 1982).

The bankruptcy court's application of this definition, however, is questionable. The Banks rightly criticize the court's mechanistic application of factors deemed relevant in other cases. See *In re Golf Course Builders*, 768 F.2d at 1170; *In re J. A. Thompson*, 665 F.2d at 949. The Official Comment to § 9-103 envisions a realistic test asking simply "where does the debtor manage the main part of its business" because that is where creditors are likely to search for information. To artificially break down that question into rigidly applied tests violates the practical nature of the inquiry as envisioned by the Uniform Commercial Code.

The Banks correctly point out that when one corporation is acquired by another, the nature of the inquiry as to the location of the chief executive office must necessarily be tailored to that situation. Ascertaining the location of the headquarters of a wholly-owned subsidiary necessarily differs from determining the location of the chief executive office of a single corporation. Re-examining the evidence presented below with more illumination than that enjoyed by the bankruptcy court, it becomes apparent that the bankruptcy court basically concluded that Metro, over time, came under the control of its parent corporation, TCS, and thus Metro's headquarters became those of TCS. This conclusion is neither legally or factually

accurate.

The bankruptcy court's analysis is flawed in several respects. First, there is a presumption that a corporation, even when it is a wholly owned subsidiary of another, is a separate entity. The law recognizes the legal distinction of affiliated corporations as do business people. To require creditors to analyze and understand the internal power structure of related corporations to determine whether the wholly owned subsidiary was "truly independent" from its parent corporation is misplaced and would introduce great uncertainty into commercial transactions, especially with respect to the filing of financing statements.

The inappropriateness of the focus of the bankruptcy court's inquiry is underscored by the evidence it relied upon. The court found relevant internal memoranda allegedly revealing the "transfer of power [that] began gradually, and then proceeded rapidly." To require creditors to scrutinize internal documents to determine the "reality" of the power structure of affiliated corporations is impractical, imprudent, and unwarranted. If, as if must be, the focus of the inquiry is shifted from analyzing the relationship between the parent corporation and its subsidiary to where Metro, the debtor, in fact had its headquarters, overwhelming evidence supports the conclusion that Metro's chief executive office remained in Rockville, Maryland until it announced the transfer in the press in December of 1984.

As previously stated, Metro's business was the

acquisition of syndication rights to sporting events as well as the sale of advertising. The bankruptcy court did not find that the activities of obtaining contracts and selling advertising[1] were no longer centered in the Rockville office, but that these activities, over time, became subjects to the final approval of Goldberg, the CEO and Chairman of the Board located in Pittsburgh. The court stated that "[b]y September the Rockville office had no more executive authority; it was merely a large sales arm of the Pittsburgh hub." 95 B.R. at 926. Once again, however, to require the creditors of a corporation to speculate as to who is calling the final shots is impractical and irrelevant. The "main part" of Metro's activities was the acquisition of syndication rights and the sale of advertising; this activity remained centered in the Rockville office until it was closed in December of 1984.

Much evidence readily available to creditors and of a more objective nature demonstrated that Metro maintained its headquarters in Rockville until December of 1984. Most importantly, contracts for syndication rights list Rockville as the principal office as late as

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[1]The evidence does show that accounting and financial services were consolidated in the Pittsburgh office shortly after the leveraged buyout. However, the location of these services is secondary to the main business of Metro corporation - obtaining syndication rights and selling advertising. Thus, the location of these services is not determinative. Moreover, it has become common practice for affiliated corporations to consolidate financial services for the corporate group in one location. The whereabouts of this streamlined accounting service does not give us much information about the location of the headquarters for each corporation.

October 5, 1984. Tax forms filed in the beginning of 1985 list Rockville as the headquarters until December 1, 1984. Representatives of athletic conferences and colleges continued to deal directly with the Rockville office at least through early October, 1984. On October 5, 1984, the Big East Conference wrote to Gail Schelat, the chief financial officer of both TCS and Metro, confirming contact negotiations. That letter, however, was addressed to the Rockville office. All of this evidence strongly supports Rockville as the "place where persons dealing with the debtor would normally look for credit information." Official Comment to § 9-103.

The only relevant piece of evidence in support of the court's conclusion that Metro's headquarters moved prior to October 5, 1984, was the July 12, 1984, newspaper announcement that stated that "TCS/Metrosports will be headquartered out of TCS's New Kensington, PA location." However, this announcement meant only that joint ventures embarked on by the newly related corporations would be coordinated out of the Pennsylvania location. Moreover, the effective date is not stated. The language used is telling-that the joint ventures will be "*headquartered out of TCS's New Kensington, PA location.*" Even this announcement did not imply that Metrosports, a separate corporate entity, had an office in New Kensington. Indeed, on the next page of the announcement, Metrosports' location is listed as Rockville, MD.

Finally, the most telling piece of evidence is not even mentioned by the bankruptcy court. On November 19, 1984, Metro announced that TCS/Metrosports was

consolidating its operations and that accordingly, Metro's headquarters, "previously in Rockville, Maryland" were being moved to Pittsburgh "*effective December 3, 1984*," and that "the firm expect[ed] to complete its consolidation of office and staff . . . by December 31, 1984." (Emphasis supplied). Thus, the bankruptcy court's conclusion is directly contrary to the debtor's public announcement as to the location of its own headquarters.

In sum, the bankruptcy court's conclusion that Metro shifted its headquarters "at least some time before October" is fraught with error. First, the court impermissibly shifted the burden of proof as to the internal balance of power between corporate executives and whether the subsidiary corporation operations were controlled by the parent corporation. Third, the court ignored considerably critical evidence that Metro continued to handle negotiation of syndication contracts, Metro's central line of business primarily out of the Rockville office until at least October 5, 1984. Finally, the court disregarded the news release stating that Metro's headquarters would be moved on December 3, 1984. For these reasons, we conclude that the bankruptcy court erred in its mixed finding of fact and conclusion of law that Metro's headquarters moved "at least some time before October."[2]

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[2]Moreover, the Committee did not put forth any evidence to satisfy th other required element of section 547, namely, that the creditor received more than it would have under the circumstances of section 547(b)(5). Section (b)(5) requires that the trustee show that the transfer had the effect of giving the creditor a greater return on his debt than

In any event, we need not decide the question whether the reperfection of a security interest in Pennsylvania during the 90 day preference period could be susceptible to attack under section 547(b) in light of our holding that the bankruptcy court erred in its ultimate mixed finding of fact and conclusion of law that the debtor's headquarters moved prior to October 5, 1984.

C. *Fraudulent Transfer Under Section 548(a)(2)*

The bankruptcy court held that Metro's guaranty and the security interest collateralizing the guaranty of the 1.85 million dollar loan to TCI which was used to buy out Metro's shareholders constituted a fraudulent conveyance under 11 U.S.C. § 548(a)(2). It is unclear whether the bankruptcy court meant this to be an alternative holding to its voiding of Mellon's security interest under section 547. At any rate, we must reach this question in light of our decision that the security interest did not constitute a voidable preference.

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would have been the case had the transfer not taken place and there had been a distribution under the liquidation provisions of the Bankruptcy Code. *In re Rude*, 122 B.R. 533, 535 (Bkrtcy E.D.Wis. 1990). In the present case, it is likely that a security interest would give Mellon Bank a distinct advantage over what it would otherwise receive in a hypothetical chapter 7 liquidation distribution, yet, the bankruptcy court failed to discuss the issue. Under these circumstances, it appears that the Committee has not satisfied its statutorily provided burden of proof as to all the required elements of section 547(b).

The present law of fraudulent conveyance has ancient roots. Section 548 is derived from the Statute of 13 Elizabeth passed by Parliament in 1571. The statute was aimed at a practice by which overburdened debtors placed their assets in friendly hands thereby frustrating creditors' attempts to satisfy their claims against the debtor. After the creditors had abandoned the effort to recover on their claims, the debtor would obtain a reconveyance of the property that had been transferred. Such transactions operated as a fraud against the debtor's creditors because the debtor's estate was depleted without exchanging property of similar value from which the creditors' claims could be satisfied.

The current embodiment of the law of fraudulent conveyances, section 548(a) provides, in full, that:

> the trustee may avoid any transfer of an interest of the debtor in property, that was made or incurred on or within one year before the date of filing of the petition, if the debtor voluntarily or involuntarily -
>
> (1) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted; or
>
> (2)(A) received less than a reasonably equivalent value in exchange for such transfer or obligation; and

> (b)(1) was insolvent on the date that such transfer or such obligation was incurred, or became insolvent as a result of such transfer or obligation;
>
> (ii) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital; or
>
> (iii) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured.

Section (a)(1) deals with actual fraud; the trustee is required to prove actual intent to defraud the debtor's creditors. Section (a)(2) addresses constructive fraud; the fraud on the creditors will be presumed if certain objective criteria are met. In this case, the Committee has made no allegations of intentional fraud. There is no evidence of any intention on the part of the parties to hinder or delay creditors or to commit any fraud. The bankruptcy court here held that Metro engaged in constructive fraud within the terms of section 548(a)(2).

At first glance, it seems difficult to reconcile the original purpose of the fraudulent conveyance laws with what has become a common, arms-length transaction - the leveraged buyout, or in business parlance, the LBO. Where there exists no intentional fraud, setting aside

the security interest of a lender who has indisputably *given* reasonably equivalent value, cash for a promise to repay a loan, appears to be a patent anomaly. As one commentator has stated, "[a] firm that incurs obligations in the course of a buyout does not seem at all like the Elizabethan deadbeat who sells his sheep to his brother for a pittance." Baird & Jackson, *Fraudulent Conveyance Law and Its Proper Domain*, 38 Vand.L.Rev. 829, 852 (1985). Nonetheless, a thorough understanding of the typical LBO transaction reveals that there is a potential for abuse of the debtor's creditors, particular those who are unsecured, when a company is purchased through an LBO.

Although the formal structure of LBOs may differ, the substance of LBOs follow a general pattern. A leveraged buyout refers to the acquisition of a company ("target corporation") in which a substantial portion of the purchase price paid for the stock of a target corporation is borrowed and where the loan is secured by the target corporation's assets. Commonly, the acquiror invests little or no equity. Thus, a fundamental feature of leveraged buyouts is that equity is exchanged for debt.

TCI's acquisition of the target Metro followed the typical pattern: Mellon extended a loan of 1.85 million dollars to TCI for the purchase of Metro; Metro guaranteed the loan and secured it with its assets, thus significantly adding to its debt structure. TCS and MCM, the parent and grandparent corporation of TCI also guaranteed the acquisition loan.

The effect of an LBO is that a corporation's

shareholders are replaced by secured creditors. Put simply, stockholders' equity is supplanted by corporate debt. The level of risk facing the newly structured corporation rises significantly due to the increased debt to equity ratio. This added risk is borne primarily by the unsecured creditors, those who will most likely not be paid in the event of bankruptcy. The lender, which normally assumes a senior, secured position vis-a-vis other creditors, is at risk only to the extent that the loan is under-collateralized. An LBO may be attractive to the buyer, seller, and lender because the structure of the transaction could allow all parties to the buyout to shift most of the risk of loss to other creditors of the corporation if the provisions of section 548(a)(2) were not applied.

The selling shareholders receive direct benefit in the LBO transaction as they are cashed out, usually at a price above the price the shares were trading shortly before the acquisition is announced. The new purchaser also benefits from the transaction by thereby achieving ownership of the corporation. The lender is attracted by the higher interest rates and fees usually associated with LBOs. The target corporation, however, receives no direct benefit to offset the greater risk of now operating as a highly leveraged corporation. As legal scholars have noted, the target firm may not at all reflect the Elizabethan deadbeat, but may in fact wind up as the sacrificial lamb. Wahl & Wahl, *Fraudulent Conveyance Law and Leveraged Buyouts*, 16 William Mitchell L.Rev. 343, 353 (1990).

The reasonableness of the remedy provided by

section 548(a)(2) has been questioned. *See e.g.* Carlson, *Leveraged Buyouts in Bankruptcy*, 20 Georgia L.Rev. 73 (1985) (lenders should have good faith defense of section 548(c) despite language requiring lender to have given value to the debtor). However, because the fraudulent conveyance laws are intended to protect the debtor's creditors, a lender cannot hide behind the position, although sympathetic, that they have parted with reasonable value. The purpose of the laws is estate preservation; thus, the question whether the debtor *received* reasonable value must be determined from the standpoint of the creditors. *But cf.*, *In re Greenbrook Carpet Co., Inc.*, 722 F.2d 659, 661 (11th Cir. 1984) (court held that although bank knew that corporation would immediately re-lend proceeds of the loan to principal shareholders to purchase a company in return for unsecured note, the issue under section 548 was "whether the *bank* received more consideration than it was due."); *Kupetz v. Wolf*, 845 F.2d 842, 847 (9th Cir. 1988) (Court refused to apply section 548(a)(2) to force selling shareholders to disgorge the payments they received where there was no indication of actual intent to defraud and no knowledge of the LBO structure used to purchase their shares.)

Moreover, the statutory language provides no exception for the leveraged buyout transaction. Section 548 applies to "any transfer of an interest of the debtor in property." The definitional section of the Act states that transfer means "every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property . . . ." 11 U.S.C. § 101(54). This

definitional language is sufficiently broad to encompass a leveraged buyout transaction that falls within its terms. We therefore turn to the analysis of the particular requirements of section 548.

Reasonably Equivalent Value

Section 548(a)(2)(A) requires the trustee to show that the debtor received "less than a reasonably equivalent value." Because Metro did not receive the proceeds of the acquisition loan, it did not receive any direct benefits from extending the guaranty and security interest collaterizing that guaranty. However, in evaluating whether reasonably equivalent value has been given the debtor under section 548, indirect benefits may also be evaluated. If the consideration Metro received from the transaction, even though indirect, approximates the value it gave TCI, this can satisfy the terms of the statute. *See Rubin v. Manufacturers Hanover Trust Co.*, 661 F.2d 979, 991 (2nd Cir. 1981) (although transfers solely for the benefit of third parties do not furnish fair consideration, the transaction's benefit to the debtor need not be direct and may come through a third party). These indirect economic benefits must be measured and then compared to the obligations that the bankrupt incurred. Here, as well as in determining insolvency under section 548(a)(2)(B)(i), it is appropriate to take into account intangible assets not carried on the debtor's balance sheet, including, *inter alia*, good will. *See Mutual Life Ins. Co. v. Menim*, 115 F.2d 975, 977 (2d Cir. 1940), *cert. denied*, 313 U.S. 578 (1941) (debtor's good will is property asset which may be sold in bankruptcy proceedings); *In re Da-Sota Elevator Co.*,

939 F.2d 654, 656 (8th Cir. 1991). The touchstone is whether the transaction conferred realizable commercial value on the debtor reasonably equivalent to the realizable commercial value of the assets transferred. Thus, when the debtor is a going concern and its realizable going concern value after the transaction is equal to or exceeds its going concern value before the transaction, reasonably equivalent value has been received.

The bankruptcy court rejected Mellon's argument that one of the indirect benefits that Metro received as a result of the LBO was the ability to borrow working capital from Mellon. The court reasoned that the 2.3 million dollar credit line extended contemporaneously with the 1.85 million dollar loan to TCI amounted to a *liability* because "all that Debtor really received was the opportunity to incur an additional $2.3 million of debt." The court concluded that because of accruing interest, Metro received "substantially less than a reasonably equivalent value in exchange." 95 B.R. at 934. This analysis is flawed. The ability to borrow money has considerable value in the commercial world. To quantify that value, however, is difficult. Quantification depends upon the business opportunities the additional credit makes available to the borrowing corporation and on other imponderables in the operation or expansion of its business.

The bankruptcy court also did not account for the value created by the LBO itself. The Banks cite what appears to be legitimate and reasonable expectation that the affiliation of these two corporations, TCS and Metro,

would produce a strong synergy. Through the LBO, Metro established a permanent relationship with a production company with highly sophisticated equipment and an experienced and reputable production and technical staff. The complimentary nature of the two corporations' businesses would appear to create a stronger and more profitable combination. What was unpredicted, however, was the Supreme Court's decision in *National Collegiate Athletic Assoc. v. Board of Regents of the University of Oklahoma*, 468 U.S. 85 (1984), which Mellon points to as the reason for Metro's dramatic and unforeseen decline. Mellon alleges that the Court's holding that certain NCAA restrictions imposed on the broadcasting of college football games of member NCAA institutions violated antitrust laws had the unexpected result of increasing competition and severely decreasing revenues from advertising. The problem universal to all LBOs-transactions characterized by their high debt relative to equity interest-is that they are less able to weather temporary financial storms because debt demands are less flexible than equity interest.

Thus the indirect benefits to Metro of this guaranty were the ability to obtain substantial credit due to its new association with the TCS corporate group and the synergy expected to result from the combination of these corporations.[3] The value, however, of the synergy

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[3]John L. Phillips, a consultant in the telecommunications industry and a certified public accountant formerly employed by Price, Waterhouse & Co., who actively assisted with the management of Total Communications, Inc., explained the benefits to be derived by the companies involved in the LBO. Speaking specifically about the benefits

obtained in the corporations' affiliation and the value of obtaining the credit are difficult to quantify in dollars without the aid of expert witnesses. Regrettably, no such testimony was forthcoming in this case.

The value of consideration received must be compared to the value given by the debtor to determine whether the debtor received less than reasonably equivalent value. The bankruptcy court correctly found

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to be derived by Metro, he testified:

> The benefits to Metro again were quite clear. Metro had a history of having to negotiate for facilities...and by having a facility like Total Communications Sytems...it had a reputation of being - having state of the art quality production equipment and it also had a reputation of having better than average production - quality production people. So this would add to Metrosports in terms of being able to in some cases upgrade the quality of its production work associated with its programming and in other cases establishing a consistency of quality because of being able to use in many respects the same people. This is very valuable to any syndicator or someone who owns rights, programming rights. It's very valuable in terms of being able to go to advertisers, okay, and to stations and be able to say, I'm going to be able to deliver you a consistency of quality of production. The other aspect of benefit to Metrosports, you don't have to be a genius to see, it received working capital.
>
> Q. Through the loans from Mellon Bank?
>
> A. Right. Which, of course, proved to be needed.

that the contingent nature of the debt was illusory because TCI had no assets of any kind except the debtor. The parties do not dispute that TCI was merely a shell corporation formed for the sole purpose of acquiring Metro. All parties, including the lender, assumed that Metro would be servicing the debt.

However, the court ignored the value of guarantees made by TCS and MCM. In valuing the cost of Metro's guaranty, the right of contribution from co-guarantors needs to be balanced against the amount of debt for which Metro is liable. Carl, *Fraudulent Transfer Attacks on Guaranties in Bankruptcy*, 60 Amer. Bank. L.J. 109, 114 (1986) ("If there are multiple guarantors of the same obligation, the right of contribution entitles a paying guarantor to have its co-guarantors pay it their proportionate share of the principal debt it paid.") Thus, the value of the guaranty, 1.85 million dollars, must be reduced to the extent contribution was available at the time of the loan from Metro's co-guarantors.

No evidence, however, has been offered regarding the value of these rights to contribution. We do know that the assets of the guaranteeing corporations were sufficiently valuable to justify an immediate additional loan by Mellon to TCS of 2.3 million dollars and letters of credit for an additional 2.25 million dollars. These loans enabled Metro, as determined by its balance sheet of June 30, 1984, immediately to achieve a very sharp rise in its broadcasting rights amounting to a grand total of $26,240,705. Although the ability to obtain credit is the lifeblood of the commercial world and governmental

operational survival, and the synergystic strength expected from the merger here, no doubt had value, the Committee introduced no evidence to support its burden of showing that Metro received less than reasonably equivalent value in exchange for its guaranty and security interest. The Committee acted on the blind assumption that they had no value and the bankruptcy court agreed.

Insolvency or Undercapitalization

Under section 548, not only must the Committee prove that the debtor did not receive reasonably equivalent value, the Committee must also prove that the debtor was "insolvent on the date that such a transfer was made or such obligation was incurred, or became insolvent as a result of such transfer." 11 U.S.C. § 548(a)(2)(B)(i). The bankruptcy court swiftly concluded that Metro was rendered insolvent by the LBO, stating that clear logic showed that "the very transactions themselves caused a *serious* case of insolvency." 95 B.R. at 934.

The bankruptcy code defines insolvency as a "financial condition such that the sum of such entity's debts is greater than all of such entity's property, at a fair valuation." 11 U.S.C. §101(31)(A). This test is frequently described as the "balance sheet test." The debtor's assets and liabilities are tallied at fair valuation to determine whether the corporation's debts exceed its assets. Under section 548, insolvency is to be measured at the time the debtor transferred value or incurred an obligation. In present case, Metro's solvency must be

measured on April 6, 1984, the date on which Metro guaranteed the acquisition loan.

The bankruptcy court reasoned that the LBO rendered Metro insolvent because it assumed that the 1.85 million paid to the former shareholders of Metro reflected the fair market value of Metro and that Metro's pledge of its stock and assets in equal amount necessarily rendered it insolvent. The court stated:

> Debtor's former shareholders were paid $1.85 million in exchange for their shares of stock. If, as is often stated, fair market value is the sum a willing buyer will pay a willing seller in an arm's-length transaction, then Debtor's stock had a fair valuation of $1.85 million. Debtor pledged its stock *and* all of its remaining unencumbered assets as collateral for said $1.85 loan guaranty. For all intents and purposes, Debtor was now liable for payment of the principal and interest on the loan, the proceeds of which it did not receive and the funding for which it did not have. A clearer case of insolvency would be difficult to construct.

In re Metro, 95 B.R. at 934. Thus, the court concluded in one short paragraph that the transaction rendered Metro insolvent. Not only is the bankruptcy court surprisingly cavalier in fashioning what amounts to a *per se* rule that LBO loans collateralized with the target's assets are fraudulent, the court's analysis is flawed by

several fundamental errors.

First, even assuming that Metro's fair market value was 1.85 million dollars, the guaranties of TCS and MCM should have been counted as reducing Metro's liability to something below 1.85 million dollars. Second, the court erred in stating that Metro "pledged its stock *and* all of its remaining unencumbered assets." Metro, of course, cannot, and did not, pledge its own stock as the corporation's stock was held by another entity - TCI. The bankruptcy court thus, in essence, double counted when it stated that Metro pledged stock as well as assets. For these reasons, as well as reasons we discuss below, the bankruptcy court's superficial analysis fails to show that the guaranty of the acquisition loan rendered Metro insolvent.

The record is sparse with respect to the financial condition of Metro at the time of the two loans on April 6, 1984, 1.85 million dollars to accomplish the stock purchase and 2.3 million dollars for working capital. James Canavan, assistant vice-president of Mellon, testified that the loans would not have been made without the guaranty and surety agreements of TCM and TCS. Although we do not have a financial statement of Metro for April 6, 1984, Metro's corporate income tax return with accompanying balance sheet for the period ending April 16, 1984, shows the total assets of the company and liabilities without the Mellon loans of April 6, 1984. The income tax return, prepared on a cash basis, does not report accounts receivable or accounts payable and, therefore, is incomplete. Nonetheless, it does reflect that the corporation had a net worth of $133,[illegible]3 at the

time and was not insolvent. Thus, it appears that the purchaser of the capital stock of Metro paid primarily for goodwill.[4] In the absence of any evidence as to the value of the accounts receivable and the sum owing on the accounts payable, and no proof of the value of Metro's rights to contribution, one cannot determine on this record whether the guaranty of the 1.5 million dollar loan and the accompanying security interest rendered the corporation insolvent.

When we examine the balance sheet of June 30, 1984, prepared on an accrual basis, after the ingestion of 2.3 million dollars working capital and the expansion of the company's broadcasting rights, we find accounts payable of $762,745. The corporations' assets have now shot up to an aggregate $28,370,697 consisting primarily

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[4]Goodwill is the difference between the value of the consideration given and the fair market value of the Company's identifiable net assets. E.R. Brownslee, K. Ferrs, M.C. Haskins, *Corporate Financing Reporting*, 144 (1990).

Although the purchaser obtained little value in tangible assets, TCI secured much more in solid expectations of the Company's future potential after the infusion of needed working capital and the benefits of the synergism effectuated by the permanent combination of three operating companies, MCM, TCS, and Metro. As for Mellon, apparently it looked for collateralization of its loans to its security interest in Metro's potential profits after the synergistic effects of the combination of the corporations and the infusion of new working capital and, most importantly, to the guaranty and surety agreements of MCM and TCS, not to the security interest in Metro's limited assets.

of broadcasting rights, and its liabilities amounted to $27,684,167, comprised principally of obligations under its broadcast rights and bank loans of $3,500,000. The net worth of the company shows improvement - now $343,265 - despite the liability of the bank loans and demonstrates that the Mellon loans did not render Metro insolvent, even without considering the value of the guarantees of TCS and MCM, but improved its financial condition.

We conclude that the Committee failed to satisfy its burden of proving that Metro was insolvent on the date of the transfer or became insolvent as a result of the transfer. As the Committee did not raise the issue of unreasonably small capital or the debtor's intent to incur debts beyond its ability to pay, we need not discuss these issues. Thus, we hold that the guaranty and security interest securing the acquisition loan did not constitute a fraudulent conveyance as provided by section 548 of the bankruptcy code.

III.

In sum, we conclude that the bankruptcy court erred in its conclusion that the debtor's chief executive office was relocated prior to October 5, 1984, and thus Mellon's refiling of its financing statements in the debtor's new location did not constitute a voidable preference under section 547(b). We also hold that the Committee failed to satisfy its burden of proof in showing that Metro failed to receive reasonably equivalent value when it executed the guaranty and security interest of the acquisition loan and that the loan

rendered it insolvent under section 548(a)(2). Accordingly, the order of the district court will be reversed insofar as it affirms the order of the bankruptcy court of February 10, 1989, as amended, and the case will be remanded to the district court with instructions to reverse the order of the bankruptcy court. Costs taxed to the appellees.

A True Copy:
Teste:

Clerk of the United States Court of Appeals
for the Third Circuit

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

NOS. 91-3105 and 91-3160

MELLON BANK, N.A.,
Appellant in No. 91-3160

v.

METRO COMMUNICATIONS, INC.
t/a METROSPORTS, debtor-in-possession,
and THE PACIFIC 10 CONFERENCE

v.

THE COMMITTEE OF UNSECURED CREDITORS
Intervenor in District Court

Grant Street National Bank (in liquidation)
Appellant in No. 91-3105

Appeal from the United States District Court
for the Western District of Pennsylvania
District Court No. 89-00782

Present: Stapleton, Hutchinson and Rosenn,

Circuit Judges

JUDGMENT

This cause came on to be heard on the record from the United States District Court for the Western District of Pennsylvania and was argued by counsel July 8, 1991.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court entered February 12, 1991, be, and the same is hereby reversed insofar as it affirms the order of the bankruptcy court of February 10, 1989, as amended, and the cause is remanded to the said District Court with instruction to reverse the foregoing order of the bankruptcy court. Costs taxed in favor of the appellants. All of the above in accordance with the opinion of this Court.

Attest:

/s/Sally Mrvos
Clerk

Dated: September 25, 1991

Costs taxed against appellees as follows:

Brief.....$ 648.80
Appendix..... 1,925.00
Docketing Fee..... 100.00

Total.....$2,709.80

Certified as a true copy and issued in lieu
of a formal mandate on October 31, 1991.

Attest: /s/Sally Mrvos

Clerk, U.S. Court of Appeals for the Third Circuit

Filed September 26, 1991

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

NOS. 91-3105 and 91-3160

MELLON BANK, N.A.,
Appellant in No. 91-3160

v.

METRO COMMUNICATIONS, INC.
t/a METROSPORTS, debtor-in-possession,
and THE PACIFIC 10 CONFERENCE

v.

THE COMMITTEE OF UNSECURED CREDITORS
Intervenor in District Court

Grant Street National Bank (in liquidation)
Appellant in No. 91-3105

Appeal from the United States District Court
for the Western District of Pennsylvania
District Court No. 89-00782

Argued July 8, 1991
Before: STAPLETON, HUTCHINSON, and ROSENN,
Circuit Judges
Opinion Filed September 25, 1991

ORDER AMENDING SLIP OPINION

The caption of the slip opinion identifying the docket numbers of appellants is hereby amended as reflected above.

BY THE COURT:

/s/ Max Rosenn
Circuit Judge

Dated: September 26, 1991

A True Copy:
Teste:

Clerk of the United States Court of Appeals
for the Third Circuit

Filed October 1, 1991

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

NOS. 91-3105 and 91-3160

MELLON BANK, N.A.,
Appellant in No. 91-3160

v.

METRO COMMUNICATIONS, INC.
t/a METROSPORTS, debtor-in-possession,
and THE PACIFIC 10 CONFERENCE

v.

THE COMMITTEE OF UNSECURED CREDITORS
Intervenor in District Court

Grant Street National Bank (in liquidation)
Appellant in No. 91-3105

Appeal from the United States District Court
for the Western District of Pennsylvania
District Court No. 89-00782

Argued July 8, 1991
Before: STAPLETON, HUTCHINSON, and ROSENN,
Circuit Judges
Opinion Filed September 25, 1991

ORDER AMENDING SLIP OPINION

The slip opinion in the above-entitled case is hereby amended as follows:

Page 4, second full paragraph, line 2, and page 27, line 10 of first paragraph, change "complimentary" to "complementary."

Page 10, first full paragraph, last line, change "possess" to "had."

BY THE COURT:

/s/ Max Rosenn
Circuit Judge

Dated: October 1, 1991

A True Copy:
Teste:

Clerk of the United States Court of Appeals
for the Third Circuit

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

NOS. 91-3105 AND 91-3160

MELLON BANK, N.A.,
Appellant in No. 91-3160

v.

METRO COMMUNICATIONS, INC.
t/a METROSPORTS, debtor-in-possession,
and THE PACIFIC 10 CONFERENCE

v.

THE COMMITTEE OF UNSECURED CREDITORS
Intervenor in District Court

Grant Street National Bank (in liquidation)
Appellant in No. 91-3105

Appeal from the United States District Court
for the Western District of Pennsylvania
District Court No. 89-00782

Argued July 8, 1991
Before: STAPLETON, HUTCHINSON, and ROSENN, Circuit Judges

Opinion Filed

ORDER AMENDING SLIP OPINION

The slip opinion in the above-entitled case is hereby amended as follows:

Page 6, last line of first full paragraph, delete "December 30, 1984" and substitute therefor "February 1 to and including February 5, 1985."

JY THE COURT:

/s/ Max Rosenn

Dated: OCT 28 1991

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

IN RE:	)	
	)	
METRO COMMUNICATIONS, Inc., t/a METROSPORTS,	)	
	)	
Debtor,	)	Civil 89-0782
	)	
MELLON BANK, N.A.,	)	
	)	
Plaintiff,	)	
	)	
vs.	)	Bankruptcy No. 85-552
	)	
METRO COMMUNICATIONS, Inc., t/a METROSPORTS, Debtor-in-possession, and THE PACIFIC-10 CONFERENCE,	)	
	)	
Defendants,	)	
	)	
vs.	)	
	)	
THE COMMITTEE OF UNSECURED CREDITORS,	)	
	)	
Intervenor.	)	

ORDER OF COURT

AND NOW, this 12th day of February, 1991, after consideration of the appeal of Mellon Bank, N.A. ("Mellon") and Grant Street National Bank ("GSNB"), from the Opinion and Order of the United States Bankruptcy Court for the Western District of Pennsylvania dated February 10, 1989, as amended by the Order dated April 4, 1989,

The court finds as follows:

1. Findings of facts by the bankruptcy court shall not be set aside unless the district court determines that such findings are clearly erroneous and due regard shall be given to the opportunity of the bankruptcy court to judge the credibility of witnesses. The bankruptcy court's conclusions of law, however are subject to plenary review. Bankruptcy Rule 8013; *Brown v. Pennsylvania State Employment Credit Union*, 851 F.2d 81, 84 (3d Cir. 1988).

2. The factual findings underlying the

Bankruptcy Court's determination that Mellon's re-perfection of its secured status constituted a transfer of debtor's property within ninety (90) days prior to debtor's bankruptcy petition are not clearly erroneous. Thus, the Bankruptcy Court properly determined that Mellon's re-perfection was a preferential transfer avoidable under 11 U.S.C. § 547. We reject appellants' contention that the Bankruptcy Court improperly placed the burden of proof on Mellon. In fact, Mellon concedes that it had the burden of proving perfection of its secured status. *See* Reply Brief for Appellants, at 2. The burden of proving the avoidability of the transfer under 11 U.S.C. § 547 was properly placed on The Committee of Unsecured Creditors ("Committee"). 11 U.S.C. § 547(g). Further, we reject appellants' contention that the Bankruptcy Court erred in suggesting, as an alternative basis for its ruling, that Mellon's original financing statements were improperly filed, since this did not serve as the basis for the Bankruptcy Court's ruling. *See In Re Metro Communications, Inc.*, 95 B.R. 921, 919-30 (Bankr. W.D.Pa. 1989).

3. The factual findings of the Bankruptcy Court that the debtor received less than reasonably equivalent value in exchange for the guaranty of loan obligations of its parent, Total Communications, Inc. ("TCI"). and that debtor was insolvent after the guaranty was issued are not clearly erroneous. Therefore, the Bankruptcy Court properly determined that the Committee met

its burden of proof under 11 U.S.C. § 548 to establish that the original acquisition of debtor by TCI constituted a fraudulent conveyance avoidable under 11 U.S.C. § 548(a)(2).

4. The factual findings underlying the Bankruptcy Court's determination that the Committee met its burden of proving that all payments by debtor by Mellon within ninety (90) days prior to debtor's bankruptcy petition were preferential transfers avoidable under 11 U.S.C. § 547(b) are not clearly erroneous.

5. We reject appellants' contention that the Bankruptcy Court's Order requiring Mellon to disgorge all payments by debtor to Mellon is overbroad. In fact, the Bankruptcy Court entered the Amended Order dated April 4, 1989 upon the motion of Mellon and GSNB to clarify the scope of the Order dated February 10, 1989. Moreover, the Committee concedes that payments by debtor to Mellon on other obligations not raised in these proceedings are beyond the scope of the above-captioned action.

6. With respect to the award of interest, the decision to award prejudgment interest is within the sound discretion of the bankruptcy court. *In Re Art Shirt Ltd., Inc.*, 93 B.R. 333, 342 (E.D. Pa. 1988). It is settled that interest awarded in voidable preference and fraudulent conveyance actions is computed from the date of demand for return, or in the absence of a demand, from the

date of the suit's commencement. *See, e.g., Smith v. Mark Twain National Bank*, 805 F.2d 278. 201 (8th Cir. 1986); *Palmer v. Radio Corp.*, 453 F.2d 1133. 1140 (5th Cir. 1971); *In Re Universal Clearing House Co.*, 60 B.R. 985. 1--2 (D. Utah 1986). Interest is calculated from the date of the transfer where the transferee acts fraudulently or in bad faith. *See In Re Southern Industrial Banking Corp.*, 87 B.R. =18, 522 (Bankr. E.D. Tenn. 1988). Here there were no allegations of fraud or misconduct requiring an award of interest from date of transfer and, thus, the Bankruptcy Court's award of interest will be reversed.

IT IS THEREFORE ORDERED that paragraph 1(d) of the Order of the Bankruptcy Court dated April 14, 1989, insofar as it orders legal interest from date of receipt, be and hereby is reversed.

IT IS FURTHER ORDERED that in accordance with the Bankruptcy Court's Order dated April 4, 1989, Mellon shall disgorge the sums discovered, with legal interest from the date of commencement of the within action, to the Registry of the Bankruptcy Court.

IT IS FURTHER ORDERED that the Order of the Bankruptcy Court dated February 10, 1989, as amended by the Order dated April 4, 1989, be and hereby is affirmed in all other respects.

/s/ Donald E. Ziegler
Donald E. Ziegler
United States District Judge

cc: Counsel of record

In re METRO COMMUNICATIONS, INC.,
t/a Metrosports, Debtor

MELLON BANK, N.A., Plaintiff

v.

METRO COMMUNICATIONS, INC., t/a
Metrosports, Debtor-in-Possession, and
The Pacific-10 Conference, Defendants,

v.

The COMMITTEE OF UNSECURED
CREDITORS, Intervenor.

Bankruptcy No. 85-552
Adv. No. 86-104

United States Bankruptcy Court,
W.D. Pennsylvania.

Feb. 10, 1989

MEMORANDUM OPINION
BERNARD MARKOVITZ, Bankruptcy Judge.

Before the Court is Mellon Bank's ("Mellon") *Complaint to Determine Secured Status*.[1] The Committee of Unsecured Creditors ("Committee"), as Intervenor,[2] has answered said Complaint, averring that various transfers made to Mellon must be avoided for the benefit of the estate, as being preferential payments, fraudulent conveyances, and/or improvidently-made postpetition transfers. Specifically, the parties agree that Debtor's chief executive office moved from Rockville, Maryland to Pittsburgh, Pennsylvania, at some time between April 6, 1984 and March 15, 1985. Mellon's secured status depends upon a factual finding that the change in chief executive office occurred on or after October 5, 1984. The Committee challenges this contention, asserting that the move occurred much earlier than October 5, 1984, and that Mellon's security lapsed before the necessary financing statements were filed. Additionally, the Committee charges that the transactions involving Debtor and Mellon rendered Debtor insolvent and/or left Debtor with an unreasonably small capital, thereby constituting a fraudulent transfer. If findings to that effect were entered, certain postpetition adequate protection Orders, submitted by Debtor and Mellon, would of necessity be vacated as having been entered

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[1]This action constitutes a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A), (F), (H), (K), and (O).

[2]Defendants in this case, The PAC-10 Conference, have entered into a settlement agreement with Plaintiff. Approval of same by this Court has been held in abeyance pending the outcome of the instant proceedings.

improvidently. Mellon denies these allegations, asserting, *inter alia*, that Debtor was neither rendered insolvent nor left with an insufficient capital base as a result of the transactions by and between the parties.

Trial was conducted with each party presenting in excess of sixty (60) exhibits; numerous witnesses were examined. The parties have briefed the issues, and have submitted proposed findings of fact and conclusions of law. After thorough analysis of the credible testimony, both oral and documentary, we find that Mellon is not a secured creditor, having failed to meet its burden of proof as to its perfected status. Therefore, any payments made to Mellon postpetition were and are inappropriate transfers. Additionally, any payments made within ninety (90) days prior to Debtor's bankruptcy filing were preferential payments and do not fall within any of the enumerated exceptions of § 547(c). Finally, we find that Debtor's guaranty of the Mellon loan to its parent was a fraudulent conveyance.

Debtor and Mellon will be directed to compile a complete and accurate accounting of all payments, made by Debtor to Mellon on behalf of itself or any of its related entities, or made by any other party to Mellon using Debtor's funds, and Mellon will be required to disgorge same, with legal interest from the date of receipt.

FACTS

Debtor was a Maryland corporation, with its chief executive office at 6151 Executive Boulevard, Rockville,

Maryland, 20852, and was in the business of television and radio sports syndication. With the exception of actual production, Debtor was engaged in all aspects of the business most significantly in the acquisition of broadcast rights, and advertising sales. Debtor had its own officers and employees and was an autonomous organization.

In April of 1984, Debtor was acquired in a leveraged buyout by a holding company called Total Communications, Inc. ("TCI"), a wholly-owned subsidiary of Total Communications Systems, Co. ("TCS"). TCI was a shell corporation, having no assets or liabilities, and was created for the specific purpose of this transaction.[3] In order to conduct this transaction the parties entered into various loan, guaranty and suretyship agreements with Mellon. On April 6, 1984, TCI received a loan of $1,850,000.00 to finance its purchase of Debtor's stock; all of Debtor's present and future assets, including its stock, served as collateral for this loan. Debtor also executed a guaranty and suretyship agreement for this TCI loan.[4]

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[3]The Mellon loan was originally made to TCS, and was approved in March 1984. Approximately ten (10) days after the transaction occurred, TCS was replaced with TCI as borrower. Said change was approved by Mellon.

[4]At no time prior to the acquisition did TCI or TCS request an *audited* financial statement regarding Debtor's financial status.

Debtor received a $2,300,000.00 working capital loan under a line of credit agreement, for which it was primarily liable, also dated April 6, 1984. TCI, TCS and Mass Communication and Management, Ltd. ("MCM"), parent of TCS, guaranteed this loan; again, however, the actual security for this loan was Debtor's present and future assets. A formal security agreement between Debtor and Mellon was also executed on April 6, 1984. All of the above-mentioned documents, executed on April 6, 1984, were signed by Leonard L. Klompus ("Klompus") on behalf of Debtor, and Nelson L. Goldberg ("Goldberg") on behalf of TCI, TCS, and MCM. UCC-1 financing statements were filed in the appropriate state and local offices in Maryland. Those financing statements, dated *April 5*, 1984, the day prior to the actual loan transaction, were signed by *Goldberg* on behalf of *Debtor*.[5]

On September 7, 1984, Debtor and Mellon entered into a letter of credit agreement to finance Debtor's purchase of broadcast rights for the PAC-10 Conference football season. Draws upon these letters of credit created a demand loan between Mellon and Debtor. This loan was also secured by the security agreement executed April 6, 1984, and was guaranteed by TCI, TCS and

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[5]It appears to this Court that even the *original* security interest may never have been properly perfected. When Goldberg executed the financing statement on behalf of Debtor, he was not yet connected to Debtor in any way. It is axiomatic that a financing statement is invalid unless *signed by the Debtor*. The financing statements signed on April 5, 19844, were *not* signed by Debtor.

MCM.

During the course of events following Debtor's acquisition by TCI, a transfer of power began to occur, from Klompus to Goldberg, from Rockville to Pittsburgh, until the Rockville office was closed and the employees therein, including Klompus, were released,

This transfer of power began gradually, and then proceeded rapidly. The seeds of its inception were planted even before the acquisition was finalized. In a letter dated February 28, 1984, from TCS counsel to Mellon, the union of Debtor and TCS was discussed in great detail. Apparently TCS was providing Mellon with an introduction to Debtor as an investment interest. The relationship is described as offering "...substantial opportunities for Nelson [Goldberg]." *Committee Exhibit 63*, and describing the importance of Debtor to TCS, as employing "...several experienced managers who will provide management depth for the *new organization*." Id. (emphasis added).

Additional insight into the transformation is provided by the "Employer's Quarterly Federal Tax Return" forms filed on Debtor's behalf. On April 3, 1984, before the acquisition occurred, William Eitze, Debtor's comptroller, prepared and filed said return from Rockville. However, the quarterly return dated July 31, 1984 is signed by Diana Acre, a TCS employee, situate in Pittsburgh. *Mellon Exhibit 16*. By July 30, 1984, Acre was the person authorized to file the quarterly employment reports with the State of Maryland, *Mellon Exhibit 15*, and the State of California

tax returns, for the employee in the Los Angeles office. *Mellon Exhibit 19*.

In June of 1984 it became apparent that the controls were being passed from Maryland to Pennsylvania. By letter dated June 13, Eitze informed Martin Singer, a vice president at TCS, that he (Singer) would soon need to address certain financial relationships in Maryland. *Committee Exhibit 64*. Eitze was cognizant that he would soon be leaving Debtor's employ, and in fact, was gone by July 14, 1984.

Undoubtedly the metamorphosis was nearly complete on July 12, 1984, when Goldberg and Klompus issued a joint press release announcing the formation of TCS/Metrosports. In that announcement, the following explanation was offered:

> TCS/Metrosports will be *headquartered* out of TCS' New Kensington, PA location (just outside of Pittsburgh), and will *operate offices* in Rockville, MD; New York, NY; and Los Angeles, CA. Goldberg will serve as chairman of the board and chief executive officer. Klompus will serve as president.

Committee Exhibit 65. (emphasis added).

In August of 1984 Gail Schelat ("Schelat"), a former Mellon loan officer, became the Chief Financial Officer of both TCS and Debtor. Ms. Schelat's work station was Pittsburgh. On September 5, 1984 Schelat advised Mellon that the Debtor, TCS and Media Sales

Corporation, the advertising arm of this conglomerate, would be sharing the use of a wholesale lock box, and that all customers would be advised of the change in procedure for remittance of accounts receivable. *Mellon Exhibit 67.* In fact, Debtor's invoices issued subsequently bore the following notice:

> Please Remit to:
> TCS/METRO
> P. O. BOX 371273
> PITTSBURGH, PA 15251

By October of 1984 Schelat had replaced Klompus in all but ministerial acts as regards the administration of Debtor. In fact, on October 3, 1984 Schelat, on behalf of Debtor, executed the Football Telecast Agreement between Debtor and the Naval Academy; this was the type of activity which was previously handled almost exclusively by Klompus. *Mellon Exhibit 24.* Two days later, Schelat wrote a letter to counsel for the Big East Conference, emphasizing the necessity for *her authorization* in all aspects of its relationship with TCS and Debtor.

> To ensure that everything proceeds smoothly and there are no misunderstandings I should be copied on all correspondence and *I must confirm* any agreements relating to our relationship, *in both TCS Productions and Metrosports.*

Committee Exhibit 27. (emphasis added).

When Debtor's bankruptcy was commenced on

March 15, 1985, Schelat signed the Unsworn Declaration Under Penalty of Perjury, averring that Debtor had been a resident of Pennsylvania for the preceding 180 days, or since September 15, 1984.

The greatest overall indication of the change in the relationship between TCS and Debtor is the parallel change in the relationship between Goldberg and Klompus, as revealed in Klompus' weekly status reports to Goldberg. Supposedly, Klompus was merely required to provide Goldberg with a highlight of the week's activities; however, even the first report, dated April 20, 1984, provides insight that Klompus no longer had the last word:

> I have enclosed the University of Oklahoma bid spec for you ...
>
> As per your request, we successfully negotiated a 90-day termination ...
>
> Everything is on hold pending your meetings ...
>
> I need your approval regarding the 1984 PGA Southern Open Golf Tournament ...

Committee Exhibit 5.

Future reports eliminate any doubt that Klompus was working *for* Goldberg rather than *with* him. In his May 4, 1984 status report, he advised Goldberg of the team effort being made by him and the others in the Rockville office to meet Goldberg's projections:

> ... *we* are going to work very hard to increase the bottom line to the 30-40% that *you* are looking for.

Committee Exhibit 6. (emphasis added.)

By the middle of May, Klompus was speaking to Goldberg on a daily basis. *Committee Exhibit 7*. As time wore on, Klompus' reports became less executive and administrative, and more sales-oriented:

> We worked today on getting all of the information in regards to the sales that you need.

Committee Exhibit 8. See also Committee Exhibit 10, which highlights an extensive West Coast sales trip and contemplates weekly return visits. By July 20, 1984, Klompus' entire report dealt with sales. *Committee Exhibit 11. See also, Committee Exhibit 13*, wherein Klompus states:

> I am now spending the majority of my day on sales, either with Media Sales or independently ...
>
> Again, in my emphasis to selling, I have been spending most of my time doing that.

These weekly reports also indicate that by August of 1984 all contracts for trade and talent were being generated by TCS counsel and were being executed in Pittsburgh; Klompus, and the remaining Rockville staff, had resigned themselves to a lesser status:

> Pursuant to our discussion on Monday, *your* decision on how to handle Media Sales at this point with *us* taking all of our time now in working sales, *it is your decision on how to go.*

Committee Exhibit 14.

By September the Rockville office had no more executive authority; it was merely a large sales arm of the Pittsburgh hub.

The payments by and among the various parties fall into at least two (2) categories: prepetition payments within the preference period, and postpetition payments. During the ninety (90) days prior to the Debtor's bankruptcy filing, the following total payments were received by Mellon:[6]

TCI Loan	$ 39,641.04
Debtor-Line Credit	94,685.94
Debtor-Demand Note	26,263.35
TCS Loans	95,036.62
	$255,626.95

[6]These numbers are based on figures provided in the parties' exhibits and may or may not be complete.

After Debtor's bankruptcy filing, Mellon received the following payments:[7]

TCI Loan $	$ 133,378.20
Debtor-Line of Credit	155,139.85
Debtor-Demand Note	1, 522,779.45[8]
TCS Loan	260,961.21
	$2,068,258.71

At this time we are unable to determine the precise amount actually paid from Debtor's funds as opposed to those funds which came from TCS. It does appear that a substantial sum was transferred postpetition from Debtor to TCS.[9]

ANALYSIS

[1] Mellon's Complaint was brought as an assertion of its secured status. It therefore has the

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[7]See Note 6.

[8]Includes two Court-ordered "adequate proteciton" payments, dated October 24, 1985 and February 10, 1986, which were based upon Consent Orders averring Mellon's secured status.

[9]Debtor's accounting provided in the main bankruptcy case at Docket Number 204, dated July 25, 1986, indicates postpetition payments to TCS totaling $719,000.00, of which $155,850.00 is directly attributable to interest expense.

burden of proving same by a preponderence of the evidence. We are initially directed by Mellon to the Uniform Commercial Code, as adopted in Pennsylvania, specifically 13 Pa.C.S.A. § 9103(c), which discusses the perfection of security interests in multi-state transactions. Mellon contends that its perfected secured status arises pursuant to § 9103(c)(4) and (5) which states in pertinent part as follows:

> (4) A debtor shall be deemed located....., at his chief executive office if he has more than one place of business....
>
> (5) A security interest perfected under the law of the jurisdiction of the location of the debtor is perfected until the expiration of four months after a change of the location of the debtor to another jurisdiction or until perfection would have ceased by the law of the first jurisdiction, whichever period first expires. Unless perfected in the new jurisdiction before the end of that period, it becomes unperfected thereafter and is deemed to have been unperfected as against a person who became a purchaser after the change.

There is no dispute that at the time of the April acquisition by TCI, the Debtor's chief executive office was located in Rockville, Maryland. It is also agreed that by the end of December, Debtor's chief executive office was situated in Pittsburgh, Pennsylvania. The issue at bar revolves around the date upon which this transfer occurred. If the move occurred on or after October 5, 1984, Mellon has a perfected security interest

in all of Debtor's assets.[10] If the change of executive office occurred prior to October 5, 1984, Mellon's perfection would have lapsed, and the filing of financing statements in Pennsylvania would constitute a re-perfection, rather than a continuation of the earlier perfected status. The import of that distinction becomes clear when one realizes that the Pennsylvania UCC filings occurred within the ninety (90) days preceding Debtor's bankruptcy filing. Therefore, if the financial statements created a new perfection rather than a continued status, that new perfection would constitute a preferential transfer under the Bankruptcy Code, 11 U.S.C. § 547, and would be avoidable.

The Official Comments to Section 9-103 explain the phrase "chief executive office", which is otherwise undefined in the context of the UCC:

> "Chief executive office" does not mean the place of incorporation; it means the place from which in fact the debtor manages the main part of his business operations. This is the place where persons dealing with the debtor would normally look for credit information.

While very few courts have analyzed this issue, the Ninth and Tenth Circuits have rendered decisions, and reached their respective conclusions using very similar analyses. Both have rejected earlier decisions, such as *Tatelbaum v. Commerce Investment Co.*, 257

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[10]However, even this conclusion is questionable - See Note 5.

Md. 194, 262 A.2d 494 (1970), which relied almost exclusively on the "volume of business" test (i.e. the chief place of business is where the majority of the business is conducted.)

Significantly, its appears that both circuit courts place great weight on the change in the Code's language from "chief place of business" (original) to "chief executive office" (amended). *In re Golf Course Builders Leasing, Inc.*, 768 F.2d 1167, 1170 (10th Cir. 1985); *In re J.A. Thompson & Sons, Inc.*, 665 F.2d 941, 950 (9th Cir. 1982). Each Court notes that the focus has been realigned to "...the location which serves as *executive headquarters* for the debtor's multi-state operation, and not on the location which generates the largest business volume." *Id.* (emphasis added.)

Both courts have also employed a two-part test to determine the location of a debtor's chief executive office, as developed from the earlier quoted language of the drafter's Committee Notes:

> (1) from which place does the debtor *manage* the main part of its business operations; and
>
> (2) where would creditors reasonably be expected to search for *credit information*?

Golf Course, 768 F.2d at 1170; *Thompson*, 665 F.2d at 949. (emphasis added).

Numerous factual indicia were considered by these courts in making their decisions; they can be categorized

as follows:

(1) existence of office autonomy;

(2) locations of officers and directors;

(3) office from which the annual report is generated;

(4) location of financial records, including bookkeeping functions, tax preparation and maintenance of payroll;

(5) office from which business is negotiated and contracts are executed;

(6) location which generates greatest revenues;

(7) area in which majority of debtor's creditors are located; and

(8) location from which primary accounting and legal services are rendered.

In analyzing the instant case, these factors will be addressed seriatim.

1. Existence of Office Autonomy

At the time of Debtor's acquisition by TCI, the Rockville office was autonomous; it had its own officers, comptroller, financial and marketing staff. All decisions were made and finalized in Rockville, Maryland. Over

time, from April through early October, Debtor's Rockville office suffered a loss of that autonomy. Goldberg and Schelat, Chief Executive Officer and Chief Financial Officer respectively, took gradual but steadily increasing control of the Debtor's business. Eitze, Debtor's comptroller, knew in June of 1984 that he would soon be released and was "laid off" in July. Thereafter, all accounting information was transmitted to the accounting department in Pittsburgh for processing. Schelat was hired in August; from that point forward, she and her staff handled the financial aspects of Debtor's business.

During that same time frame, April through early October, Klompus began to lose control over contract negotiation and decision making in general; with Schelat taking final authority for contracts and Goldberg making all major decisions. Klompus was reduced to an advertising salesman by the end of August. Goldberg began to lose faith in Klompus, and therefore, took his power away.[11] That Goldberg could in fact *take* the power is a prime indication that Rockville was no longer an autonomous office. To the contrary, the power and control were found in Pittsburgh, Pennsylvania.

2. Location of Officers and Directors

The major officers were effectively split between

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[11]At some time after December 14, 1984, a lawsuit was instituted against Klompus and others by Mass Communications and Management, TCS and TCI. That suit has since been dismissed.

Pittsburgh and Rockville: Goldberg, the CEO and Chairman of the Board was located in Pittsburgh; Klompus, the President, was in Rockville; Schelat, the CFO, was situated in Pittsburgh; Cherner-Klompus and Karisson, both vice presidents, were located in Rockville.

The weight of the evidence indicates that Goldberg and Schelat had the ultimate control well before October 5, 1984. As earlier noted, Klompus' weekly reports and daily conversations with Goldberg provide significant insight, as does Schelat's testimony that she was hired by Goldberg in August specifically to oversee and review Klompus' activities. Klompus pursued sales and ran various business errands in Rockville, Maryland; however, the management of the bulk of Debtor's business operations, and the only place to secure credit information, was found in Pittsburgh, Pennsylvania.

3. Annual Report Generation

No testimony was provided on this issue. We have no indication that any annual report was ever generated. The likelihood of same is reduced by the fact that the Debtor filed bankruptcy less than one year after the acquisition occurred. However, from the testimony and exhibits offered, it is clear to the Court that had such a document been considered, surely the "powers" of this corporation, located in Pittsburgh, would have made the decision whether or not to issue such a document, and would have had substantial input regarding substance and/or content. Some of the

employees in Maryland would have supplied a portion of the information; however, its genesis and exodus would stem from Pittsburgh.

4. Location of Financial Records Including Bookkeeping, Taxes and Payroll

At the time of the April-1984 acquisition, all of the Debtor's financial records were kept in Rockville, and were handled by Eitze.

When he left in July-1984, all financial duties were turned over to the Pittsburgh accounting office.

Schelat arrived in August-1984 and took primary responsibility for all financial aspects of Debtor's business including, but not limited to, accounts payable and receivable; general ledgers; and balance sheets and financial statements. Tax preparations were delegated by Schelat to other Pittsburgh staff, primarily William Jackson, controller, and Diana Acre, a bookkeeper.

We are unable to make a determination as to payroll preparation, in large part because the testimony was very limited. However, Schelat testified that her salary expense was shared between TCS and Debtor, although she was listed on TCS' payroll.

5. Office From Which Business is Negotiated and Contracts are Executed

Plaintiff attempted to give the impression that after the acquisition Klompus was still the Debtor and

the Debtor was still Klompus. This conclusion is not supported by the credible factual data.

Originally Klompus handled all contract rights and most negotiations, with any legal aspects of same being channeled through Maryland counsel. As time progressed, Klompus was required to clear all negotiations through Goldberg, and often met or spoke with Goldberg before and after negotiating sessions. After Schelat was hired by Goldberg, in August of 1984, she became extensively involved in the negotiation process, and her approval was *required* on all contracts - even those previously negotiated by Klompus.

Additionally, TCS' counsel, Robert Krause, became more and more involved in negotiating and drafting contracts between Debtor and others; eventually, Krause handled all matters of legal import.

6. Location Which Generates Greatest Revenue

In April of 1984 Rockville generated all of the Debtor's revenues as all accounts were handled there. By early September a lock box arrangement had been installed with Mellon. All TCS, Metro, and Media Sales receipts were directed to said lock box and credited to appropriate parties. However, we have no real testimony as to which office *actually* generated the greatest revenues.

7. Location of Creditors

This item is not really applicable as Debtor had creditors all over the country (i.e. advertisers, individual schools, college conferences, television and radio stations) and ascertaining a central location is not feasible.

8. Location From Which Primary Accounting and Legal Services Are Rendered

The Debtor originally employed Maryland and Washington, D.C. attorneys and accountants to handle all legal and tax matters, with Eitze handling day-to-day financials "in house". After the acquisition by TCS, Krause began to perform all of the Debtor's legal work as it related to negotiations and contracts, with local Maryland counsel handling certain specific lawsuits and other various and sundry court proceedings.

Similarly, after the departure of Eitze, all accounting was transferred to Pittsburgh, with Schelat and her staff handling most financials and receiving outside tax and/or audit assistance from Touche Ross' Pittsburgh office.

[2] Based upon the foregoing, it is clear that at least some time before October, and most apparently by late August, Debtor's "chief executive office" had moved from Rockville, Maryland to Pittsburgh, Pennsylvania. Therefore Mellon's UCC-1 financing statements, filed in Pennsylvania on February 1st, 4th and 5th, 1985, did not operate to continue any perfected status; rather, said filing *re*-perfected Mellon's secured

status.[12] Since this re-perfection constitutes a transfer of the Debtor's property, and since it occurred within ninety (90) days prior to Debtor's bankruptcy filing, Mellon's perfection is an impermissible preference and must be avoided. By the same analysis, any postpetition payments made pursuant to said perfected status, including but not limited to the court-ordered adequate protection payments, must be vacated and/or reversed as having been improvidently paid.

[3] Mellon contends that it remains entitled to retain those payments made by Debtor within the ninety (90) day preference period; it claims that said payments fall within the exception found at § 547(c)(2), commonly called the "ordinary course" exception, which states as follows:

> **(c) The trustee may not avoid under this section a transfer -**
>
> > **(2) to the extent that such transfer was -**
> >
> > **(A) in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee;**

---

[12]As stated *supra*, at Note 5, there is good cause to argue that Mellon was never properly perfected until the Pennsylvania filings occurred. Since they are the avoidable preferential transfers, there may never have been proper perfection between Debtor and Mellon. For the purpose of continuity, we refer to it above as "re-perfection".

> (B) made in the ordinary course of business or financial affairs of the debtor and the transferee; and
>
> (C) made according to ordinary business terms;...

The three (3) questions which are raised by this exception are properly phrased, in our present scenario, in the following manner:

> (1) Was the *original* debt incurred in the ordinary course of business of both Debtor and Mellon?
>
> (2) Were the payments by Debtor to Mellon during the ninety (90) day period, made in the ordinary course of business of both Debtor and Mellon?
>
> (3) Were the payments by Debtor and Mellon during the ninety (90) day period made according to ordinary business terms?

See, In re Vunovich, 84 B.R. 629 (Bankr. D.Kan. 1987).

In order to succeed on the exception, Mellon must supply this Court with a preponderance of proof, enabling affirmative answers to *all three* questions. ***WJM. Inc. v. Massachusetts Dept. of Public Welfare***, 840 F.2d 996 (1st Cir. 1988); ***In re RDC Corporation***, 88 B.R. 97 (Bankr. W.D.La. 1988); ***In re First Software Corp.***, 81 B.R. 211 (Bankr. D.Mass. 1988);

In re Cleveland Graphic Reproduction, Inc., 78 B.R. 819 (Bankr. N.D.Ohio 1987); *In re Antinarelli Enterprises, Inc.*, 76 B.R. 247 (Bankr. D.Mass. 1987).

While the answers to these questions rest in large part upon factual determinations, it is important to evaluate those facts with an eye toward the overall purpose of this exception, which is:

> ...to leave undisturbed normal financial relations, because it does not detract from the general policy of the preference section to discourage unusual action by either the debtor or his creditors during the debtor's slide into bankruptcy.

H.R.Rep. No. 95-595, 95th Cong., 1st Sess. 373 (1977); S.Rep. No. 95-989, 95th Cong., 2d Sess. 88 (1978), U.S.Code Cong. & Admin. News 1978, pp. 5787, 5874, 6329. *See also, WJM, Inc., supra; First Software, supra; Cleveland Graphic, supra; In re Day Telecommunications, Inc.*, 70 B.R. 904 (Bankr. E.D.N.C. 1987).

> (1) Was the *original* debt incurred in the ordinary course of business of both Debtor and Mellon?

As a banking institution, Mellon makes loans on a daily basis for a multitude of purposes. It would therefore appear that all three (3) loans, i.e. the LBO/stock purchase, the working capital, and the PAC-10 letter of credit, were made in Mellon's ordinary course of business.

Whether these loans were made in Debtor's ordinary course of business is another question entirely. Debtor was in the broadcasting and advertising business; only if these loan transactions were normally conducted as part of Debtor's broadcast and/or advertising business should they be considered within the ordinary course of its business. *In re Daikin Miami Overseas, Inc.*, 65 B.R. 396 (Bankr. S.D.Fla. 1986). Arguably, the letter of credit and working capital loans fall within this caveat, although it is unclear whether Debtor regularly borrowed funds for working capital or obtained letter of credit financing for broadcast right acquisitions. In any event, however, the LBO/stock purchase loan is highly extraordinary in nature and no company's borrowing to allow for the purchase of its own stock could ever be considered part of the ordinary course of its business.

> (2) Were the payments by Debtor to Mellon during the ninety (90) day period, made in the ordinary course of business of both Debtor and Mellon?

As stated previously, the condition of Debtor's financial records leaves a great deal to be desired. However, through use of certain bank records, we are able to construct a pattern, if not a precise dollar figure. Each loan will be discussed separately for factual purposes.

The LBO/stock purchase loan was constructed to be paid on a monthly basis, with payments due on the 17th of each month. From May 1984 through September

1984 payments were made by Debtor each month, within two (2) weeks after the due date. The October 17, 1984 payment was not made until November 16, 1984. During the preference period, from December 15, 1984 through March 15, 1985, payments became very tardy and uneven. The November 17, 1984 billing was paid on January 1, 1985. The December 17, 1984 billing was paid on February 7, 1985. The January 17, 1985 and February 17, 1985 billings were paid in one lump sum on March 15, 1985, the day of the bankruptcy filing. This account was regularly paid by check; the March 15, 1985 payment was made by wire transfer.

LBO/Stock Purchase Loan Payments

Payment Due Paid	Payment Made	Amount
05-17/84	05-31-84	$20,370.22
06-17-84	06-25-84	21,381.14
07-17-84	07-26-84	21,027.33
08-17-84	08-21-84	21,937.16
09-17-84	09-21-84	21,937.16
10-17-84	11-16-84	20,964.14
11-17-84	01-11-85	20,660.86
12-17-84	02-07-85	18,967.54
01-17-85 and 02-17-85	03-15-85	36,519.36

The working capital loan was also drawn to be payable on a monthly basis. Again the payment due date was the 17th of each month. Initially Debtor made all payments within nine (9) days after said due date. The October 1984 payment was one (1) month late andy

thereafter, during the preference period, payments were two (2) months in arrears. Two (2) payments were made in March 1985; the second was again sent by wire transfer on March 15, 1985, the date of the bankruptcy filing. The normal payment method on this loan was by corporate check.

Working Capital Loan Payments

Payment Due	Payment Made	Amount Paid
06-17-84	06-25-84	$27,147.54
07-17-84	07-26-84	26,142.08
08-17-84	08-21-84	27,273.22
09-17-84	09-21-84	27,273.22
10-17-84	11-16-84	26,063.52
11-17-84	01-14-84	25,702.19
12-17-84	02-07-85	23,581.29
01-17-85	03-04-85	22,953.82
02-17-85	03-15-85	22,448.64

The bank's records relating to the letter of credit demand loan were far less complete; the only figures available relate directly to the preference period. The payment due date on this loan was the first day of each

month. The payments for January 1, 1985 and February 1, 1985 were made on March 1, 1985 and March 15, 1985, respectively. The means by which the March 1, 1985 payment was made is unknown; however, Debtor's course of dealing was payment by check. Again, however, the March 15, 1985 payment was accomplished by wire transfer.

Letter Of Credit Demand Loan Payments

Payment Due	Payment Made	Amount Paid
01-01-85	03-01-85	$ 8,247.94
02-01-85	03-15-85	18,015.41

Lateness of payments is a key factor in deciding whether payments fall within the parameters of the ordinary couzse of business exception. Several courts have held that untimely payments are outside the ordinary course of business and are therefore avoidable. *Marathon Oil Co. v. Flatau*, 785 F.2d 1563 (11th Cir. 1986); *In re RDC Corp., supra*. In each case the payments which began as normal, regular and ordinary course became sporadic and hurried. Indeed, Mellon received at least $76,983.41 on the very day the bankruptcy was filed and an additional $31,201.76 within two (2) weeks prior thereto. While the payment on the working capital loan appeared to be "normal" in amount, the other payments made on that date were nearly twice that of a "regular" payment. Payments of unusual size and/or made in any unusual manner are also considered outside the ordinary course. *See Marathon*

Oil Co., supra; In re RDC Corporation, supra; In re Antinarelli Enterprises, Inc., supra; In re Vunovich, supra; In re Bourgeois, 58 B.R. 657 (Bankr. W.D.La. 1986).

> (3) Were the payments by Debtor to Mellon during the ninety (90) day period, made according to ordinary business terms?

[4] This element has been handled in two (2) different fashions by the Courts which have discussed this exception. The majority of said Courts limit their analysis to the manner and timing of payments between the individual parties. *See Matter of Unimet Corporation*, 85 B.R. 450 (Bankr. N.D.Ohio 1988), and cases cited therein. The minority approach is to examine this element from a broader perspective, i.e. determining the consistency of the parties' practices in relation to their industry counterparts. *Id.* The rationale for this view was aptly stated by the Court in *In re Steel Improvement Company*, 79 B.R. 684 (Bankr. E.D.Mich. 1987):

> The difficulty with the majority approach is that either it ignores subparagraph (C) of Section 547(c)(2) and thereby makes it a nullity, or it interprets subparagraph (C) to require the same showing as subparagraph (B) and thereby makes it superfluous ...

Viewing subparagraph (C) as an element separate and distinct from subparagraph (B) is required. In the case at bar no testimony or evidence was offered

regarding industry standards relating to payments in the ordinary course. Therefore, Mellon has not met its burden as to this element.

In summary then, the LBO/stock purchase loan fails to meet any of the criteria necessary to fall within the section 547(c)(2) exception. The other two loans fail to meet two of the three requirements. Therefore, the exception is inapplicable.

The Committee has raised a counterclaim in this adversary proceeding, asserting that the original acquisition of Debtor by TCI was a fraudulent conveyance, which must also be avoided. It has alleged violations of § 548(a)(2)(A) and (B)(i) or (ii), which states in pertinent part:

> (a) The trustee may avoid ... any obligation incurred by the debtor ... on or within one year before the date of the filing of the petition, if the debtor voluntarily or involuntarily - ...
>
> (2)(A) received less than a reasonably equivalent value in exchange for such ... obligation; *and*
>
> (B)(i) was insolvent on the date that ... such obligation was incurred, or became insolvent as a result of such ... obligation; [or]
>
> (ii) was engaged in business ... or was about to engage in business ... for which any property remaining with the debtor was an unreasonably small capital; ...

[5] We begin by asserting that Section 548 of the Bankruptcy Code is applicable to leveraged buyouts. The language of § 548 refers to *any* transfer, and a leveraged buyout is, by its very terms, a transfer of an interest in property. *See Matter of Ohio Corrugating Co.*, 70 B.R. 920 (Bankr. N.D.Ohio 1987). Additionally, § 548 parallels, in many respects, the Uniform Fraudulent Conveyances Act ("UFCA"), as adopted in Pennsylvania, 39 P.S. § 351 *et seq.* (Purdon's); and it appears that in most instances, those cases which analyze the various state law expressions of the UFCA will be applicable in cases brought specifically under § 548.

[6] The burden of proving all elements of this allegation rests with the Committee, *In re Morris Communications NC Inc.*, 75 B.R. 619 (Bankr. W.D.N.C. 1987); *In re Uhlmeyer*, 67 B.R. 977 (Bankr. D.Ariz. 1986); *In re Coors of North Mississippi, Inc.*, 66 B.R. 845 (Bankr. N.D.Miss. 1986); because the allegations of § 548(a)(2) involve constructive fraud as opposed to actual fraud, the Committee must prove its elements by preponderence of the evidence. In order to prevail, the Committee must prove the following:

(1) the Debtor incurred an obligation;

(2) the debt was incurred within one year prior to the bankruptcy filing;

(3) in exchange for incurring the obligation, debtor received less than a reasonably equivalent

value; and

(4) the Debtor was either insolvent or severely undercapitalized on the transfer date, or was so rendered by the transfer.

See In re Ohio Corrugating Co., 91 B.R. 430 (Bankr. N.D.Ohio 1988); *In re Butcher*, 72 B.R. 447 (Bankr. E.D.Tenn. 1987).

The parties admit that Debtor incurred obligations on April 6, 1984, including the $2.3 million line of credit loan, and a guaranty of the $1.85 million loan incurred by its parent. The parties further agree that these obligations were incurred within one (1) year prior to Debtor's bankruptcy filing. Therefore, the Committee must prove that Debtor received less than a reasonably equivalent value for the obligations incurred *and* that Debtor was or became insolvent or undercapitalized.

The intent behind the fraudulent conveyance provision of the Bankruptcy Code is to preserve the estate assets for the benefit of the creditors. *See Matter of Ohio Corrugating Co.*, 70 B.R. at 927. In the instant case we find a group of loans to affiliated corporations along with cross-guaranties. Such guaranties can be categorized by three (3) different classifications:

A. a downstream guaranty, wherein a parent guarantees a subsidiary's obligation;

B. a cross-stream guaranty, wherein a subsidiary

guarantees the obligation of its sister corporation; and

C. an upstream guaranty, wherein a subsidiary guarantees the parent's obligations.

See Carl, Fraudulent Transfer Attacks on Guaranties in Bankruptcy, 60 Am. Bankr. L.J. 109 (1986).

The instant case involves no cross-stream guaranties. Additionally, downstream guaranties, such as TCI, TCS and MCM's guaranties of Debtor's line of credit loan, are generally believed to be given for reasonably equivalent value, because the parent is the sole stockholder of the principal debtor, and any benefit received by the subsidiary is also a benefit to the parent. *In re W. T. Grant Co.*, 699 F.2d 599 (2nd Cir. 1983); *In re Augie/Restivo Baking Co., Ltd.*, 87 B.R. 242 (Bankr. E.D.N.Y. 1988); *In re Lawrence Paperboard Corp.*, 76 B.R. 866 (Bankr. D.Mass. 1987). Upstream guaranties, on the other hand, are not very well protected. Transfers by a debtor which operate solely or principally to benefit an affiliated entity will constitute fraudulent transfers when the other elements of a fraudulent transfer are present. *Rubin v. Manufacturers Hanover Trust*, 661 F.2d 979 (2nd Cir. 1981); *In re Lawrence Paperboard, supra*; *In re Holly Hill Medical Center, Inc.*, 44 B.R. 253 (Bankr. M.D.Fla. 1984). These same courts, and others, recognize that indirect benefits *may* furnish fair consideration, *provided*, however, that the value received by the Debtor is *reasonably equal* to the value of the obligation given. *Rubin, supra.*; *Klein v. Tabatchnick*, 610 F.2d 1043

(2nd Cir 1979); *Mandel v. Scanlon*, 426 F.Supp. 519 (W.D.Pa. 1977); *Ohio Corrugating, supra*; *Lawrence Paperboard, supra*.

In the case at bar Debtor guaranteed a $1.85 million loan granted to its parent, TCI. TCI used said money to purchase Debtor's shares from Debtor's former shareholders. TCI collateralized the loan by pledging Debtor's stock, Debtor's guaranty and Debtor's security interest in all of its unencumbered assets. Debtor therefore has given up its stock and all other assets in exchange for $1.85 million of allegedly contingent debt. However, the contingent nature of said debt is illusory. TCI is a shell; a holding company. It had no assets of any kind except the Debtor, and the only means of debt repayment which ever existed was assumption of the obligation by Debtor.

Mellon asserts that Debtor received *more* than reasonably equivalent value because it obtained a $2.3 million line of credit. Such circular logic merely begs the question, because all that Debtor really received was the opportunity to incur an additional $2.3 million of debt. If Debtor drew against the line of credit, and it did, Debtor would have a present cash asset. Debtor would also have a newly created identical liability, which would soon be greater than the asset due to accruing interest. It is clear that Debtor incurred an obligation for which it received *substantially less* than a reasonably equivalent value in exchange.

The only remaining element is Debtor's insolvency or undercapitalization. Many of the courts

discussing this issue have developed complicated formulae and descriptions to determine if a debtor was insolvent or undercapitalized, or was so rendered by the transaction. Some analyze vast financial data in terms of "generally-accepted accounting principles." None of that is necessary in the instant case. By clear logic, the very transactions themselves caused a *serious* case of insolvency, which has been defined under the Code as "when the sum of [its] debts is greater than all of [its] property, at a fair valuation." 11 U.S.C. § 101(31)(A). *See also, Ohio Corrugating*, 91 B.R. at 436; *In re Join-in International (USA) Ltd.*, 56 B.R. 555 (Bankr. S.D.N.Y. 1986).

On April 6, 1984, Debtor had a $1.85 million debt, for which it had pledged all of its assets and for which Debtor received no part of the actual $1.85 million. Debtor's former shareholders were paid $1.85 million in exchange for their shares of stock. If, as it is often stated, fair market value is the sum a willing buyer will pay a willing seller in an arms-length transaction, then Debtor's stock had a fair valuation of $1.85 million. Debtor pledged its stock *and* all of its remaining unencumbered assets as collateral for said $1.85 million loan guaranty. For all intents and purposes, Debtor was now liable for payment of the principal and interest on the loan, the proceeds of which it did not receive and the funding for which it did not have. A clearer case of insolvency would be difficult to construct.

Having found that the Committee has proved all of the necessary elements, we hold that leveraged buyout

among the parties to the action was a fraudulent conveyance which must be avoided.

An appropriate Order will be issued.

ORDER OF COURT

AND NOW, at Pittsburgh in said District this 10th day of February, 1989, in accordance with the foregoing Memorandum Opinion of this date evenwith, it is hereby ORDERED, ADJUDGED and DECREED as follows:

(1) Plaintiff, Mellon Bank, does not possess a valid security interest in Debtor's assets;

(2) As a result thereof, Debtor and Mellon must compile a complete and accurate accounting of all payments made by Debtor to Mellon, on behalf of itself or any of its related entities, or made by any other party to Mellon, using Debtor's funds;

(3) Debtor and Mellon will file said accounting with the Court within sixty (60) days of the date of this Order;

(4) Concurrently with said filing, Mellon will disgorge the sums so discovered, with legal interest from date of receipt, to the Bankruptcy Court Registry.

IT IS FURTHER ORDERED that the original transaction among the parties, dated April 5 and/or 6, 1984, involving the leveraged buyout of Debtor's stock was a fraudulent conveyance transfer and BE and IS hereby AVOIDED.

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

IN RE:

METRO COMMUNICATIONS, INC., t/a METROSPORTS,	:	Bankruptcy No. 85-552
Debtor	:	
**********	:	
MELLON BANK, N.A.,	:	
Plaintiff	:	
v.	:	
METRO COMMUNICATIONS, INC., t/a METROSPORTS, Debtor-in-Possession, and THE PACIFIC -10 CONFERENCE,	:	
Defendants	:	
v.	:	Adversary No. 86-104
THE COMMITTEE OF UNSECURED CREDITORS,	:	
Intervenor	:	

AMENDED ORDER OF COURT

AND NOW, at Pittsburgh in said District this 4th day of April, 1989 upon consideration of: (1) the motion of Grant Street National Bank (In Liquidation), as successor in interest to Mellon Bank, N.A. in the instant adversary proceeding, to Amend the Judgment Order of this Court dated February 19, 1989; (2) the Committee's Motion To Strike Grant Street National Bank's Motion To Amend Judgment; and (3) the Response thereto of Mellon Bank, N.A. and Grant Street National Bank (In Liquidation), it is hereby ORDERED, ADJUDGED and DECREED that effective this date evenwith, Grant Street National Bank (In Liquidation) is joined in this action as an additional plaintiff and counterclaim defendant.

IT IS FURTHER ORDERED THAT:

(1) the decretal portions of this Court's Order of February 10, 1989 are hereby amended as follows:

(a) Plaintiff, Mellon Bank, does not possess a valid security interest in Debtor's assets;

(b) As a result thereof, Debtor and Mellon must compile a complete and accurate accounting of all payments made by Debtor to Mellon, on behalf of itself or any of its related entities, or made by any other party to Mellon, using Debtor's funds;

(c) Debtor and Mellon will file said accounting with the Court within sixty (60) days of the

date of this Order;

(d) Concurrently with said filing, Mellon will disgorge the sums so discovered, with legal interest from date of receipt, to the Bankruptcy Court Registry, except to the extent that such sums represent payments received by Mellon more than ninety (90) days prior to March 15, 1985 for application against Debtor's obligations in respect of the Letter of Credit Agreement dated September 7, 1984 and the $2,300,000.00 working capital loan under the Line of Credit Agreement dated April 6, 1984; and

(2) the original transaction among the parties, dated April 5 and/or 6, 1984, involving the leveraged buyout of Debtor's stock was a fraudulent transfer and BE and IS hereby AVOIDED.

Nothing in this Order shall be interpreted as an extension of time within which to file an appeal; no such request has been made or granted.

/s/ Bernard Markovitz
BERNARD MARKOVITZ
U. S. Bankruptcy Judge

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IN THE UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

IN RE:

METRO COMMUNICATIONS, INC., t/a METROSPORTS,	:	Bankruptcy No. 85-0552
Debtor	:	
**********		
MELLON BANK, N.A.,	:	
Plaintiff	:	
v.	:	
METRO COMMUNICATIONS, INC., t/a METROSPORTS, Debtor-in-Possession, and THE PACIFIC -10 CONFERENCE,	:	
Defendants	:	
v.	:	Adversary No. 86-0104
THE COMMITTEE OF UNSECURED CREDITORS,	:	
Intervenor	:	

ORDER OF COURT

AND NOW, at Pittsburgh in said District this 15th day of May, 1989, upon consideration of the motion of Mellon Bank, N.A. and Grant Street National Bank (in Liquidation) (together, the "Banks"), plaintiffs and counterclaim defendants, for approval of supersedeas bond, and just cause appearing for the relief requested, it is hereby ORDERED, ADJUDGED and DECREED as follows:

1. The bond annexed to the motion, in the amount of $3,000,000.00 with the Banks as co-principals and The Aetna Casualty and Surety Company as surety, is hereby APPROVED.

2. Pursuant to Bankruptcy Rules 8005 and 7062, the "Amended Order of Court" dated April 4, 1989, amending the earlier "Order of Court" dated February 10, 1989 entered in the adversary proceeding is hereby STAYED to the extent that it requires Mellon Bank, N.A. to pay into the Bankruptcy Court Registry any sum disclosed by the accounting that the Debtor and Mellon Bank, N.A. is required to file pursuant to said Order, until such time as all appeals and other proceedings for post-judgment relief in respect of such Order have been finally resolved.

3. It is the determination of this Court, in the interest of fostering a speedy, economical and orderly resolution of the appeal, that the Order of Court dated February 10, 1989, as amended April 4, 1989, was a final Order of this Court determining the issues placed

before the Court by the parties participating in that proceeding. We see no reason for delay, and we expressly DIRECT the entry of judgment on said Order of February 10, 1989 as amended on April 4, 1989. This Court takes no position as to the timeliness of the appeal to the United States District Court.

/s/ Bernard Markovitz
BERNARD MARKOVITZ
U. S. Bankruptcy Judge

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FILED
May 15 1989

CLERK, U.S. BANKRUPTCY COURT
WEST. DIST. OF PENNSYLVANIA

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

NOS. 91-3105 and 91-3160

MELLON BANK, N.A.,
Appellant in No. 91-3160

v.

METRO COMMUNICATIONS, INC.
t/a METROSPORTS, debtor-in-possession,
and THE PACIFIC 10 CONFERENCE

v.

THE COMMITTEE OF UNSECURED CREDITORS
Intervenor in District Court

Grant Street National Bank (in liquidation)
Appellant in No. 91-3105

SUR PETITION FOR REHEARING

BEFORE: SLOVITER, Chief Judge, BECKER, STAPLETON, MANSMANN, GREENBERG, HUTCHINSON, SCIRICA, COWEN, NYGAARD, ALITO, ROTH, and ROSENN, Circuit Judges

The petition for rehearing filed by appellee in the above-entitled case having been submitted to the judges who participated in the decision of this Court and to all the other available circuit judges of the circuit in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular active service not having voted for rehearing by the court in banc, the petition for rehearing is denied.

By the Court,

/s/ Walter K. Stapleton

Dated: OCT 23 1991